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TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 5294

AN ACT MAKING APPROPRIATIONS FOR THE TREASURY DEPARTMENT, THE UNITED STATES POSTAL SERVICE, THE EXECUTIVE OFFICE OF THE PRESIDENT, AND CERTAIN INDEPENDENT AGENCIES, FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 1987, AND FOR OTHER PURPOSES

Administrative Conference of the United States
Advisory Commission on Intergovernmental Relations
Advisory Committee on Federal Pay
Committee for Purchase From the Blind and Other Severely Handicapped
Department of the Interior
Department of the Treasury
Executive Office of the President
Federal Election Commission
Federal Labor Relations Authority
General Services Administration
National Archives and Records Administration
Nondepartmental witnesses
Office of Personnel Management
U.S. Merit Systems Protection Board
U.S. Postal Service
U.S. Tax Court

Printed for the use of the Committee on Appropriations

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TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

WEDNESDAY, MARCH 12, 1986

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:20 p.m., in room S-126, the Capitol, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor and Mattingly.

ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

STATEMENT OF MARSHALL J. BREGER, CHAIRMAN

ACCOMPANIED BY:
STEPHEN L. BABCOCK, EXECUTIVE DIRECTOR
RICHARD BERG, GENERAL COUNSEL

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order. This afternoon will begin our fiscal 1987 budget overview. Today we are going to receive presentations from the Administrative Conference of the United States, the U.S. Tax Court, the Committee for Purchase from the Blind and Other Severely Handicapped, the Advisory Commission on Intergovernmental Relations, the Merit Systems Protection Board, the Office of Special Counsel, the Advisory Committee on Federal Pay, and the Federal Labor Relations Authority. I did that deliberately so you all will know we have a full slate this afternoon. We have your complete statements that you have taken the time to prepare in detail, and I assure you they will all be made a part of the record.

I am going to forego any further opening remarks. We do not have to call on any other Senators for opening statements, so we are sailing along.

Marshall, you have the great privilege of being the first witness before this illustrious committee. We welcome you, Marshall Breger, as Chairman of the Administrative Conference. This is your first appearance. We want to welcome you to the committee. We are not as mean as you have heard. We try to get along with people, and we are looking forward to working with you. So you just go right ahead. Summarize in a hurry and we will give you your questions and you can be on your way.

Mr. BREGER. Thank you, very much, Mr. Chairman. I am very grateful. This is my maiden voyage in testifying, and I already feel much more comfortable than I thought I would.

BUDGET REQUEST

The Administrative Conference, as you know, is an advisory agency with the mission of recommending to the President, the Congress, and the Federal agencies ways to improve the fairness and the efficiency of the administrative procedures that Federal agencies use.

This includes procedures and processes used by the agencies to conduct rulemakings, to take action on an informal basis, and to hold agency hearings. The Conference also advises the Judicial Conference of the United States on matters of administrative law relating to the judicial review of agency decisions.

We are, therefore, a kind of in-house think tank on administrative law issues for the Government agencies, Congress, and the executive branch, and we come before you with a budget mark of $1,559,000. This mark, we hope, will allow us to resurect our research program, which has been severely limited in recent years. This year, for example, we will only be able to spend about $50,000 in actual research, which is the stuff of our work. This mark will also allow us to intensively develop our implementation efforts.

As you know, our recommendations are published in the Federal Register and then printed in the Code of Federal Regulations. We want to go further than that and have the agencies implement our ideas because we think they are useful ones. We have not had in the past sufficient capacity to discuss with agencies—discuss with the Hill—the ideas we have, and move more effectively in the implementation process.

We believe that the President's budget mark will allow us to begin to do that in an effective and efficient way.

CURRENT RESEARCH PROJECTS

Let me give you very brief examples of the kind of work that we are now doing. This June, for example, we will be discussing a recommendation on the use of alternatives to adjudication in administrative agencies, trying to get us out of this terrible obsession with litigation, the obsession with formally going to court in the administrative agencies. There has been work done on this so far in the court system, regarding alternatives to adjudication. There has been very little work in the administrative agencies themselves.

We also will be doing a study of the ways in which nonlawyers can be of assistance to parties and participants in Federal agency proceedings. This will include problems of what we call mass justice programs like SSA, the Social Security Administration, Veterans' Administration, Immigration and Naturalization Service [INS], where they have hundreds of thousands of cases and where lay people can be attorneys or lay people can be experts. We might save a lot of expense. We might increase efficiency, and we might even get more justice. This is another area that we are involved in.

We also do what you might call more technical legal work, such as our study of the use of the Federal rules of evidence in administrative adjudications. Are we going to have some organized and unified approach toward administrative adjudications?

We hope this next year to focus not only on our traditional themes of rulemaking, improving rulemaking, of the use of ALJ's, administrative law judges; on a number of particular areas where we think if we coalesce our work we might have greater impact.

We want to focus, as I suggested earlier, on this whole question of alternate dispute resolutions, getting out of the formal mode of litigation. We have a study of the Health and Human Services Department's Grant Appeals Board, which emphasizes ways of looking to settlement procedures and to alternate dispute resolution in these grant appeals. We went to continue that work in a whole variety of areas, and indeed we have a working group on the use of regulatory negotiations in rulemaking. We also want to focus on effective use of Government financial resources. We are doing a study of user fees and are trying to develop a coherent theory.

We are doing a study of the use of private attorneys by Federal Government agencies. This is an area that has grown up in the last few years and no one has really looked at it. I might add here, Mr. Chairman, that, in an attempt to be as efficient as we can, we have secured the assistance of a law firm, pro bono, to do this project. We also are studying the Federal Debt Collection Act to see how that act is working and how it can be improved.

We also, within our limited resources, want to tackle further problems of Government tort liability. We did some pioneer work in the Federal Tort Claims Act, and we want to continue that work in the Federal tort claims area. This is a very brief example of the kind of work we are doing and the kind of work we hope to do, given the support of the President's budget mark.

PREPARED STATEMENT

Thank you very much, and I would be happy to answer any questions either orally or in writing.

[The statement follows:]

STATEMENT OF MARSHALL J. BREGER

My name is Marshall J. Breger. I became the Chairman of the Administrative Conference of the United States on October 28th of last year. I am thus succeeding Loren A. Smith, who, as you may know, has become the Chief Judge of the United States Claims Court. I have with me today the Executive Director of the Conference, Mr. Stephen Babcock, the General Counsel, Mr. Richard Berg, and the Research Director, Mr. Jeffrey Lubbers.

Today is my first opportunity to appear before this Subcommittee. I want you to know that I am genuinely pleased to have this opportunity to present our budget to you. My staff tells me that you, Mr. Chairman, and the members of this Subcommittee, as well as your staff, have always taken an active interest in our affairs. You have been firm, but fair, stewards of the government's money with respect to the Administrative Conference, and I look forward to working with all of you during my tenure as Chairman.

As you can see, the figure of $1,559,000--the request in the President's budget for this agency--represents an increase of $190,000 over our figure for the current fiscal year, after the reduction of $61,000 made as a result of the Gramm-Rudman-Hollings legislation. This increase, although minuscule from the standpoint of this Subcommittee's bill, is a healthy sum for the Administrative Conference, and I very much want to tell you how I intend to use it to advance our work of making administrative procedures simpler and less costly.

First, however, I'd like to tell you a bit about the Administrative Conference and what it has been doing in the past twelve months since we were last here before you.

The Administrative Conference is an advisory agency with the mission of recommending to the President, the Congress and the Federal agencies, ways to improve the fairness and efficiency of the administrative procedures that the Federal agencies use. This includes the procedures and processes used by the agencies to conduct rulemakings, to take action on an informal basis, and to hold agency hearings. The Conference also advises the Judicial Conference of the United States on matters of administrative law relating to judicial review of agency decisions.

The Conference's advice is given principally in the form of formal recommendations that are debated and adopted by vote of the Conference's 91 members. These voting members of the Administrative Conference, apart from myself, are 90 volunteers: 49 from the various departments and agencies, and 41 from outside the government. These 90 persons are the government's top legal officers, the leading academics in the field of administrative law, and others from private life who are knowledgeable concerning governmental processes.

The Conference is headed by a Chairman, myself. The Chairman is an advice-and-consent appointee with a term of five years. The Chairman presides over meetings of the membership. He also heads the Office of the Chairman, the permanent staff, which has, at the moment, 19.6 full-time equivalent employees. The Conference also has a 10-member Presidentially-appointed Council, consisting of five government officials and five members from outside the government. The Council's function is like that of a corporate board of directors.

Government members of the Conference, of whom there are forty-four, are designated by the heads of the departments and major agencies. They are typically department or agency general counsels, commissioners, assistant secretaries, or the like. The thirty-six public members--those from outside the government--are appointed by the Chairman with the consent of the Council. They serve for terms of two years, also without pay. A total of fifty members are thus Federal officials, and the other forty-one members are from outside the government--members of the public selected for their expertise in administrative law and their knowledge of government processes. Because of the prestige of being a Conference member, the government receives, without cost except for travel expenses, the services of corporate general counsels, leading law professors, private practitioners, and others with a wide variety of backgrounds, accomplishments and perspectives.

The process by which the Administrative Conference develops recommendations is as follows. The Chairman initially decides to pursue a particular topic on the basis of suggestions from Conference members, Members of Congress, agencies or others. When a topic has been defined, the Chairman's staff begins the process of finding a consultant--typically a law professor who already has some knowledge about the particular subject. The consultant will interview agency officials, review the literature, and write a 100 to 300 page report on the problem. The staff Research Director and one or more of the staff attorneys work closely with the consultant, and with the chairman and the members of the appropriate Conference standing committee, throughout this process.

When the consultant's report has been prepared it is given to the members of one of our six standing committees of members (all members serve on one of these committees), and the committee develops a proposed recommendation. The Council then reviews the recommendation prepared by the committee and, if it believes the proposal has received sufficient attention, the Council places it on the agenda of the next semi-annual general meeting--or Plenary Session.

At the Plenary Session, the proposed recommendation is thoroughly debated by the members. Often recommendations are amended. Occasionally, they are referred back to committee or killed outright. If a recommendation is adopted, however, it is published in the Federal Register, and is sent to the agencies or to the Congress, as appropriate. The past recommendations of the Conference are also set out in the Code of Federal Regulations.

Implementing Conference recommendations is another important part of the activities of the staff of the Office of the Chairman. The Office maintains a separate file on each past recommendation, in which information received about agency compliance with that recommendation is kept. Most implementation efforts, however, are responsive: since the Conference has advisory powers only, the staff must remain alert to indications that one or more agencies, or a Congressional committee, is interested in a problem that relates to one or more past recommendations. The staff, or the Chairman personally, will then ensure that the interested body is aware of the Conference recommendation and will offer assistance.

Since our governing statute does not give us powers to compel compliance with our recommendations, but rather reflects a conscious decision by the Congress not to give the Administrative Conference anything more than the tools of persuasion, our implementation activities are of necessity confined to attempting to encourage agencies to undertake such efforts. But, on balance, I cannot say that it should be otherwise. For if the departments and agencies were afraid of the Administrative Conference, we would not enjoy the tremendous amount of cooperation from which we now benefit. And our efforts to obtain information from the agencies leading to recommendations would largely be fruitless if the Administrative Conference were seen as a threatening institution rather than as a helpful one. As my predecessor Chairman said in his testimony before you last year, the Administrative Conference tries to be a "user-friendly" body (the users being the Federal departments and agencies) rather than a policeman.

The Office of the Chairman also engages in fairly extensive advisory and consultative activities. These are undertaken when we receive requests from agencies and Congressional committees for views on procedural problems or on aspects of pending legislation. In such situations, the Chairman or staff of the Office of the Chairman will assist, including testifying where appropriate, based on their own expertise and/or on research reports contained in the Office's excellent library of administrative law materials. Sometimes the requests for our involvement are statutory, as when the Congress asked us to work with the Government in the Sunshine Act, to report on the Federal Trade Commission's hybrid rulemaking procedures, or to act as a consultant and reporter on the Equal Access to Justice Act.

The fourth major category of Administrative Conference activities comes under the heading of clearinghouse activities. The Office of the Chairman is mandated by the Administrative Conference Act to "arrange for interchange among administrative agencies of information potentially useful in improving administrative procedure." 5 U.S.C. 574(2). Our activities under this heading include holding formal and informal meetings for agency personnel, operating informal groups such as the Council of Independent Regulatory Agencies, and producing compilations and documents of use to agencies generally.

During the past twelve-month period, the Administrative Conference has adopted five formal recommendations and one formal statement. (A statement differs from a recommendation in that it states the views of the Administrative Conference without calling for specific agency or Congressional action.) The Conference adopted three of these recommendations at its Plenary Session in June of 1985, and two additional recommendations, plus the one statement, at its Plenary Session held this past December.

The first of the recommendations adopted in June of 1985, Recommendation 85-1, "Legislative Preclusion of Cost/Benefit Analysis," urges that Congress state explicitly in regulatory legislation whether it intends to prohibit the administering agency from applying cost/benefit analysis in adopting regulations. This recommendation thus addresses the situation in which Congress precludes an agency's use of cost/benefit analysis to consider the potential costs, benefits, or risks associated with a contemplated regulatory action. The Conference recommended that legislation containing such a preclusion use specific language to make clear Congress' intent.

The second recommendation adopted at that session, Recommendation 85-2, is entitled "Agency Procedures for Performing Regulatory Analysis of Rules." This recommendation suggests ways in which agencies can more effectively integrate regulatory analysis into their decisionmaking process, including ways to use regulatory analysis for better identification of regulatory options. This recommendation also addresses the use of regulatory analysis where it is not specifically required, or where certain avenues of inquiry are foreclosed by the agency's statutory authority. The recommendation also advises agencies on the kinds of information that should be included in such analyses, on procedures for obtaining and using information, on the use of consultants, and on the limits of this technique.

Recommendation 85-3, "Coordination of Public and Private Enforcement of Environmental Laws," proposes certain administrative steps that the Environmental Protection Agency can take to achieve better coordination between its enforcement process and so-called "citizen suits" that are authorized under various environmental statutes. The Conference suggests that EPA, as feasible, should indicate its views on enforcement criteria, on the calculation methods for penalties, and on settlement procedures and policies. EPA was also advised to consider improving the quality of information available about the compliance status of regulated persons and firms and the outcome of environmental actions. Finally, the Administrative Conference suggested in this recommendation that when EPA receives notice from a private party of an alleged violation, the agency should ask that party to keep EPA informed about any related actions to which EPA is not itself a party.

Recommendation 85-4, "Administrative Review in Immigration Proceedings," adopted at our Plenary Session this past December, deals with administrative appeals from initial Justice Department decisions in deportation, exclusion, and other immigration proceedings. These appeals are decided by one of two very different bodies: the formal, relatively independent Board of Immigration Appeals, or the smaller, less independent Administrative Appeals Unit. The recommendation urges the

Justice Department to review the assignment of cases to these two bodies in light of several factors, such as the importance of the type of case to the parties, the type of issues raised, and the number of cases of each particular type. The recommendation, based on these considerations, suggests specific assignments for some of the types of cases. It also recommends statutory recognition for the Board of Immigration Appeals and the adoption by it of a three-member panel system.

Recommendation 85-5, "Procedures for Negotiating Proposed Regulations," also adopted in December, reaffirms the Conference's earlier advice to agencies, given in 1982, suggesting the use of negotiated rulemaking techniques in certain circumstances. In negotiated rulemaking, an agency faced with a regulatory problem brings together representatives of potentially affected groups to negotiate a rule in face-to-face meetings. In the earlier 1982 recommendation, the Administrative Conference had outlined procedures for the negotiation of rules, and had advised agencies to experiment with the concept. Since that time, the negotiated rulemaking technique has been used successfully by the Federal Aviation Administration and the Environmental Protection Agency. On the basis of a study of agency experience with negotiated rulemaking, the Conference supplemented and refined, in this recommendation, the procedures described in the earlier recommendation.

Finally, the Administrative Conference adopted a formal statement at its December 1985 Plenary Session. (As indicated earlier, a "statement" calls attention to a particular problem or states Conference views without calling for definite action.) This statement, "Hearing Procedures for the Resolution of Scientific Issues," suggests continued experimentation by agencies with alternative types of hearing procedures for the resolution of scientific issues arising in their proceedings. The statement was based primarily on a study of the Food and Drug Administration's Public Board of Inquiry, an innovative attempt to provide an informal hearing by a panel of scientists as an alternative to formal adjudication by an administrative law judge of issues concerning food additives or new drugs. Based on the FDA experience, the Conference urged that agencies with regulatory programs that depend on scientific determinations consider experimental use of a process similar to FDA's Board. The statement noted several steps that could be taken to improve the management of such proceedings to make them more efficient and accurate.

While the Office of the Chairman of the Administrative Conference spends a majority of its time in connection with the production of recommendations, the Conference, as noted at the outset of this testimony, also engages in a number of other activities, categorized under the headings of implementation, advisory and consultative, and clearinghouse projects.

Under the category of implementation activites, we continued during the past twelve months, as in the past, to maintain information on the status of all past Administrative Conference recommendations, and to call attention to recommendations when circumstances warrant. Two areas, however, received special attention during the past year. The first of these concerns our Recommendation 80-5, "Eliminating or Simplifying the 'Race to the Courthouse' in Appeals from Agency Action."

This recommendation deals with the problem that, when agency decisions are appealable to the United States Courts of Appeals, the appeal can often be brought in any one of a number of different circuits, and when more than one petition for review is filed, the historical rule for determining which court should hear and decide the appeal has been that the first petition to be filed determines the circuit. Those parties who believe that they will have an advantage in a particular circuit often employ open telephone lines, walkie-talkies, and multiple filings (e.g., one every few seconds at the minute that they think the agency will make its decision final and hence appealable). This "racing" is costly to parties, makes the judicial process seem a bit ridiculous, and creates sometimes considerable problems for the various circuit courts of appeals, who have no practicable means of determining which appeal was two, one, or even a fraction of a second ahead of another. Resolving this problem can add months, or even a year, to the appellate process.

The Administrative Conference recommendation, adopted in 1980, would call for a random selection to decide which court should hear the appeal when more than one petition is filed within ten days after the agency's decision becomes appealable. Our proposal was included in various omnibus regulatory reform bills, but did not become law because of problems with these bills generally. Accordingly, the Administrative Conference then sought to have its provision introduced as a separate bill, and this effort was successful in the House of Representatives, which passed H.R. 439, incorporating our recommendation, in May of 1985. We have subsequently had several meetings with interested staff and members on the Senate side, and hope to have some further progress on this matter during the year.

The second Administrative Conference recommendation that has received special attention during the past twelve-month period is Recommendation 82-4, "Procedures for Negotiating Proposed Regulations." As indicated earlier, negotiated rulemaking has been tried in a few instances, and has proved extremely successful for particular types of controversies. In addition to working on the refinement of this earlier recommendation adopted in December of 1985 as Recommendation 85-5, the Administrative Conference staff have worked with EPA, OSHA, DOT and other agencies that have used or displayed interest in the procedure. The staff have also created an informal interagency group of persons interested in further experimentation with this concept, and, further, have advised those in Congress interested in the area.

Under the heading of advisory and consultative activities, the Administrative Conference has provided letters or comment or testimony on a number of bills during the past year, at the request of committees of Congress having jurisdiction. These include H.R. 2378 and H.R. 5479, legislation reauthorizing the Equal Access to Justice Act; H.R. 3335 and S. 1134, the Program Fraud Civil Penalties Act of 1985; H.R. 439, the Race to the Courthouse bill discussed earlier; H.R 441, the Tort Claims Act amendments; S. 451, the Regulatory Negotiation Act of 1985, and H.R. 729, the Panama Canal Amendments Act of 1985 (claims settlement provisions). I should also note here that we recently testified before the Senate Judiciary Committee's Subcommittee on Administrative Practice and Procedure, chaired by Senator Grassley of Iowa, on our own reauthorization legislation, and we are preparing for our House testimony on the same subject, our hearing being scheduled during this month.

The staff of the Office of the Chairman also provide advice, either in written form or orally, to large numbers of Department and agency personnel on a tremendous variety of administrative law questions. These projects, often quite informal, are too numerous to mention individually. Agencies receiving advice on questions during the past twelve months ranged from the Department of State to the Navaho and Hopi Indian Relocation Commission and the General Accounting Office.

Finally, under the heading of clearinghouse and special projects, the Administrative Conference also continued its mix of new and continuing activities during 1985.

The most noteworthy of the new activities was the acompletion and publication, in July 1985, of a very useful reference work produced by the staff of the Office of the Chairman. In that month the Administrative Conference published its *Federal*

Administrative Procedure Sourcebook: Statutes and Related Materials. This volume is intended to serve as a basic introduction and reference book on the 15 major procedural laws affecting the operation of federal agencies. These statutes are: the Administrative Procedure Act, the Agency Practice Act, the Claims Collection Act, the Contract Disputes Act, the Debt Collection Act, the Equal Access to Justice Act, the Ethics in Government Act, the Federal Advisory Committee Act, the Federal Tort Claims Act, the Freedom of Information Act, the Government in the Sunshine Act, the National Environmental Policy Act, the Paperwork Reduction Act, the Privacy Act, and the Regulatory Flexibility Act.

The *Sourcebook*, directed to agency personnel (both lawyers and non-lawyers), researchers, and practicing attorneys, explains the operation of these statutes. The book discusses briefly each statute's purpose, operation, legislative history, relevant case law, implementing regulations, and bibliographic resources. For each law, the *Sourcebook* also includes citations, the text, and interpretive materials from the Department of Justice, OMB, the Conference, and other lead agencies. Nearly ten thousand copies of the *Sourcebook* have been distributed to federal agencies, private attorneys, state and local governments, and others. We have provided copies of this work, for which we have received numerous requests from Federal agency personnel, with this testimony.

The Administrative Conference also continued, during the year, to operate the informal group of independent agency chairmen, known as the Council of Independent Regulatory Agencies, and the management-oriented small agency group, known as the Agency Management Information Group. These groups both continued to perform the same kinds of activities that they had undertaken in previous years. The Conference also co-sponsored, with the American Bar Association, a very useful symposium on Federal Disability Benefit Programs that was held in Cleveland, Ohio in October of last year. Finally, under this heading, we can report that the Administrative Conference conducted the final series of Colloquia on Regulatory Design in Theory and Practice. This monthly series was commenced by the Administrative Conference three years ago, and, after the successful completion of a series of seminars in July of 1985, the series was "privatized," in that it is now being undertaken by a private organizer, without the further necessity of expending Administrative Conference staff time on its operations. We are also providing, with this testimony, a copy of Volume

III, for the year ended in July of 1985, of the Proceedings of these colloquia compiled at year's end.

Having summarized our past-year activities, let me turn to our current plans for the coming year. We have included with this testimony a list of research projects that are currently underway and, as you can see, the Administrative Conference is continuing the kinds of research that it has traditionally undertaken. Our current research centers around the themes of improving the rulemaking process, exploration of alternative, informal methods of agency adjudication or dispute resolution, and improving the process of handling tort and other claims against the government. We intend to pursue this kind of research in fiscal 1987, and to commission new projects of the same kind.

The Gramm-Rudman-Hollings reduction for fiscal 1986 for this agency amounted to $61,000. This amount came out of our current research budget, and left us with few resources for the commissioning of new projects during the remainder of this fiscal year. Fiscal 1986 will thus be a lean year in terms of commissioning new projects to put into our pipeline of ongoing activities. The "mark" that we have received from the President in his budget, however, will allow us to restore our research to its modest but adequate level prevailing in Fiscal Year 1985. Thus, while we will not have the resources to engage in a number of large, empirical-research-intensive projects, we will be able to replenish our stock of ongoing projects.

I should mention, at this point, that, as a result of the Gramm-Rudman-Hollings reductions, we have redoubled our efforts to find funds for those projects that other agencies might be willing to fund. I am pleased to be able to report that we have been successful in one instance, in that we have received committments, which we believe to be firm, from two agencies to assist in a new project on the general subject of user fees for Federal agency services. We are also experimenting with a "pro-bono" project on the subject of Federal agencies' use of private attorneys, being conducted by the Philadelphia law firm of Wolf, Block, Schorr & Solis-Cohen. We have agreed to pay the firm's out-of-pocket expenses, but the time that they will devote to this project will be considerable, and it will all be donated to the Administrative Conference.

These kinds of funding are no substitute for having an adequate appropriation, of course, because we cannot count on being able to find agencies or private sources that have funds that they can expend--especially, in so far as agencies are concerned, in the environment of necessary reductions that the government is facing. But I mention this to assure you that the Administrative Conference will continue to attempt to maximize its resources in every way possible.

The second new initiative that I hope to undertake in fiscal 1987 is to augment our efforts at implementation, both with Federal agencies, to whom the bulk of our recommendations are addressed, and with respect to the Congress itself. With respect to both agencies and the Congress, the ultimate effectiveness with which the Administrative Conference performs its mission suffers because we are not well enough known. Some Committees on the Hill, for example, know us and seek our advice routinely, while others, through institutional lack of contact or through changes in staff, do not know of our work.

I cannot tell you at this point in time exactly what I intend to do in this area, but, resources permitting, I hope to add the effective capacity of one professional to our staff to concentrate on these efforts.

There could also be one very good side-effect of increased activity both with agencies and the Hill: as I, being a new Chairman, have reviewed the efforts of the Administrative Conference in past years, and I think that among the most valuable work the agency has performed has been in response to Congressional mandates. I'm thinking especially here of the Administrative Conference's role in the Equal Access to Justice Act, where I believe we were both extremely cost-effective and extremely valuable in terms of preserving Congressional intent. I think that the Administrative Conference was cost effective because we developed one model rule, after agency participation, which saved the time of thirty-three agencies having to separately go through the thinking, drafting, and publishing-for-comment that we did. And I think it is equally clear that the Conference's work helped to produce good rules, faithfully reflecting Congress's intent.

I welcome additional roles of this kind for the Administrative Conference (as we have performed in response to other legislative mandates in the past), and I believe that having sufficient funding to "beef up" our efforts to make ourselves better known, which funding the President's request to you provides, will assist us to carry out more such assignments.

Before I conclude, I also wish to call your attention to the fact that the Administrative Conference has requested, and the President has included within his request, the sum of not to exceed $1,000 to be expendible, under rulings and regulations of the Comptroller General, for the official entertainment of foreign visitors. In recent years, as the reputation of the Administrative Conference has grown, we are pleased that we are visited from time to time by members of foreign judiciary systems, law professors, officials with ministries of justice or central management agencies and the like. Former Chairmen and senior staff have expended small sums of their personal funds for modest but appropriate entertainment (usually lunches or di(n)ners) for such individuals. If you are disposed to give us this funding, I can assure you that it will be spent in accordance with regulations, not lavishly, and only on my signature.

Mr. Chairman and members of the Subcommittee, this concludes my prepared testimony. I thank you for your attention, and I hope you will remember, in considering our request, that the Administrative Conference's work results in considerable savings to the government as it goes about its work in the administrative law area, and also to the citizens who seek to use the administrative processes in their dealings with the government.

We stand ready to respond to any questions that you may have.

List of Active Research Projects

(1) Bakken, Larry (Hamline) Agency use of non-ALJ hearing officers. (Status: Data collection completed; case studies chosen, draft report expected by summer.)

(2) Beck, Leland (D.C.) Study of specialized courts for the review of administrative agency decisions. (Status: Revised outline submitted; draft report due this month.)

(3) Braden, Susan (D.C.) Study of FTC and Antitrust Division intervention and competition advocacy activities. (Status: Awaiting draft report.)

(4) Cane, Robert (California Western) Preliminary survey of INS and State Department handling of visa and related applications. (Status: Primarily report completed; it urges an in-depth study; under review by INS.)

(5) Cappalli, Richard (Temple) In-depth study of innovative adjudicative techniques used by the Grant Appeals Board at the Department of Health and Human Services. (Status: Data gathering underway with full cooperation of the Board; draft report due March, 1986.)

(6) Cass, Ronald (Boston U.) Development of a unified theory of compensation for government wrongs. (Status: Preliminary paper delivered at June, 1985 Plenary Session, further work is in conjunction with special ACUS Committee on Governmental Torts.)

(7) Diver, Colin (Boston U.) Division of roles in joint federal/state enforcement programs. (Status: Data gathering underway; draft report due August, 1986.)

(8) Funk, William (Lewis and Clark) Review of experience under the Paperwork Reduction Act. (Status: Draft report submitted; to be considered by Committee on Rulemaking in March.)

(9) Grunewald, Mark (Washington & Lee) Proposal for an administrative tribunal to resolve FOIA and other public access disputes. (Status: Draft report submitted; to be considered by Committee on Judicial Review in March.)

(10) Harter, Philip (D.C.) Agency use of alternatives to adjudication. (Status: Draft report submitted; to be considered by the Committee on Administration in March.)

(11) Hostetler, Zona (D.C.) Non-lawyer assistance to parties and participants in federal agency proceedings. (Status: Report submitted by Professor Rose on economic regulatory agencies did not lead to recommendation; Committee on Regulation requested further study of "mass justice" programs such as the INS, SSA, VA. Draft report submitted; to be considered by Committee in March.)

(12) Johnson, George (George Mason) Split enforcement model (OSHA-OSHRC)--how is it working? (Status: Draft report submitted; to be considered this month by the Committee on Adjudiction.)

(13) Kinney, Eleanor (Indiana) Study of Medicare appeals process. (Status: Just underway; outline due this month; draft report on August 15, 1986.)

(14) Levinson, Harold (Vanderbilt) State administrative law as a source of innovations for adaptation and use by the Federal Government. (Status: In progress; many spinoffs, including legislative veto options paper.)

(15) Luneburg, William (Pittsburgh) Agency handling of petitions for rulemaking. (Status: Just underway, aiming for December, 1986 Plenary Session.)

(16) Mason, Malcolm (D.C.) Preparation of a guidebook for better drafting of grant and assistance-related statutes. (Status: ACUS Staff Attorney Charles Pou is overseeing this project; several meetings with interested lawyers and members of Congressional and agency staff have been held; partial draft of guidebook has been submitted.)

(17) Morgan, Thomas (Emory) Feasibility of regulatory budget proposals and other methods of regulatory cost accounting. (Status: Outline approved by Committee on Regulation; draft report due in March.)

(18) Pierce, Richard (Pittsburgh) Study of use of Federal Rules of Evidence in administrative adjudications. (Status: A survey of ALJs has been undertaken; draft report has been submitted; to be considered by Committee on Adjudiction this month.)

(19) Powell, Burnele (North Carolina) Agency use of declaratory orders under the APA. (Status: Report submitted; under consideration by Committee on Administration; with further consideration of supplemental report and new draft of recommendations in spring of 1986.)

(20) White, Martin (Western New England) Procedural questions raised by the Debt Collection Act of 1982. (Status: Preliminary report received from earlier consultant and was reviewed by Committee on Administration; in-depth study transferred to new consultant due to illness; data gathering underway; draft report due in September, 1986.)

(21) Wolf, Bloch, Schorr & Solis-Cohen (Philadelphia) Study of federal agency hiring of private attorneys. (Status: This study undertaken on pro bono basis by the firm. Interviews in progress; hearing to be scheduled in spring; draft report due July 15, 1986.)

INTRODUCTION OF ASSOCIATE

Senator ABDNOR. Thank you. I neglected to introduce Chuck Parkinson, a staffer from my side. Many of you have already worked with him. On my left is Bobby Mills. Senator DeConcini could not make it. Did he want to put in a statement?

Mr. MILLS. We have some questions, Mr. Chairman.

Mr. BREGER. May I take the liberty, Mr. Chairman, of introducing as well, having neglected that duty myself, Mr. Stephen Babcock, my chief of staff, and Mr. Richard Berg, my general counsel.

Senator ABDNOR. Well, you are in good hands. We know the work of Mr. Babcock on this committee in the past. But it sounds like you outlined a lot of work for these people to do.

What has been the track record in your recommendations to these agencies? Have some of them implemented some of your recommendations? I do not mean now, but I mean over the years.

Mr. BREGER. Our track record has been pretty good. It is hard to quantify because often while we are doing work the agency sees the light, so to speak, and it makes a change in medias res, you might say, while we are in the middle of our study.

Very often agencies come to us and say we have a problem. We would like you to help us sort it out using your expertise. Again, our reports are published in the Code of Federal Regulations. They are out there. The agency, in a way, has to respond, and say why we are not implementing this. We have had some discussions with OMB in an effort to try to more formalize the implementation procedure.

At the same time, I have to stress, we feel that by being what I might call user friendly, by using a carrot approach rather than a stick approach with the agencies, we are in the long run more likely to receive implementation and compliance. And, as I say, I think our record has been pretty good, but we think it can be better if we are able to systematically approach that problem.

Senator ABDNOR. I want to ask you a question I will probably ask most of the agencies: Can you outline how you have allocated the cuts mandated by the Gramm-Rudman-Hollings, and to supplement that, I would ask you to provide a complete breakout for the record itself later. How have you allocated those cuts?

Senator ABDNOR. Let me ask Mr. Babcock to respond.

Mr. BABCOCK. Mr. Chairman, we have allocated those cuts to our research funding, which is the only wholly discretionary part of the object class budget breakdown. As you may know, we are a one-line agency. We only have one appropriation. And we took the $61,000 which was our Gramm-Rudman cut for this year out of that object class, 25.0 other services.

At the same time, we have been going around, amongst our staff members, talking, looking for ways, can we use messenger service less frequently, and we are trying to, without having to furlough anybody, reduce our other expenses as much as we can so that we hope by the end of the year we can put some of that back in our research program. That is the situation.

Senator ABDNOR. Can we talk about the SLUC charge for a moment. It has increased considerably over the fiscal 1986 year. Could you tell us why. Are you using more space or is this strictly an increase as a result of the GSA rate adjustment?

Mr. BABCOCK. It is strictly a result of a GSA rate adjustment. We are not using any more space, not even 1 square foot more. Every year they propose to increase our space rate, and we take an appeal and do what we can to show that our space is not more expensive than in other comparable buildings, and sometimes we do better than in other years. That is the answer. I will quit.

Senator ABDNOR. A small item, maybe, but one that we find in controversy sometimes. You are requesting representation fund authority totaling $1,000, and I am not making little of $1,000. Could you outline how these funds will be utilized. The House committee, as you may know, has been reluctant to approve these requests without proper authorization language being in place. Has there ever been any legislation in the past or even this year sent to Congress? If not, I think you ought to get that authorized.

Mr. BABCOCK. Well, this legislation or this proposed budget mark is the first time that we would have authority for entertainment expense. Nothing has ever come up to the Hill before. This request came up in the President's budget.

Senator ABDNOR. Do you think you should have authorizing legislation?

Mr. BREGER. I believe that that will be included in our new authorizing legislation. Indeed, we have some suggestion that that is the case. We are about to be reauthorized.

Senator ABDNOR. Well, we have been much more agreeable on this, I think, in the past than the House. This is not the first time this has come up.

Mr. BABCOCK. For us it is. For other agencies, I know, there are some in this room——

Mr. BREGER. Perhaps I can just make a clarifying point, Mr. Chairman. We are not requesting this for any domestic entertainment, you might say in-house domestic entertainment or any entertainment of people in the Government.

We receive many, many foreign visitors. We are constantly asked by the U.S. Information Agency [USIA] to meet with foreign visitors largely because our analog in other countries—every foreign country has an analog to the Administrative Conference, and those analogs are in many cases a very active, an integral part, of the governments of those countries.

As a result, we receive innumerable visitors and we feel we have a responsibility to be hospitable, and at the moment the hospitality, it comes out of the personal pocketbooks of some of the agency members.

Senator ABDNOR. I am just saying we will talk to the authorizing committee, too, and it will be a lot better. It will clear up a lot of argument. Either that or you had better spend some time with the other subcommittee.

Mr. **Babcock**. We will look into this and do whatever is necessary, Mr. Chairman, I can assure you.

Senator **Abdnor**. Last year you were forced to observe a 5 percent pay reduction like everyone else. Does this request for fiscal 1987 provide a makeup for the cut?

Mr. **Babcock**. No, sir.

CONFERENCE MEMBERSHIP

Senator **Abdnor**. It does not. OK. And, for the record, later on would you provide an updated list of the membership of the Conference?

Mr. **Babcock**. We will indeed.

[The information follows:]

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ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. We have other questions which we will submit for your response for the record. Do you have any you want to ask orally?

Mr. MILLS. No, sir.

Senator ABDNOR. Gentlemen, we thank you very much.

Mr. BREGER. Thank you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question. Your request for fiscal year 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen?

Answer. This year, we reduced our budget authority by 4.3 percent because of Gramm-Rudman. This reduction was taken directly from our research budget, and we had very little left with which to commission new projects which would in the normal course become actual Conference recommendations during the next 2 fiscal years.

The same thing would happen to us if we were forced to take a similar reduction in fiscal year 1987. The effect, however, would be more serious, in that it is much more difficult to continue to function with an inadequate research budget for two years in a row than with an inadequate budget in only one year, when that one year is an isolated phenomenon. If this such problem were to occur in successive years, it would become even more difficult to keep an acceptable flow in our research activities.

Question. Would it be too much to assume that if you lived with the reduction in fiscal year 1986, you could certainly utilize that level as a base in 1987?

Answer. Utilizing the reduced 1986 resources as a base in fiscal year 1987 would destroy capacity to maintain an adequate level of funding of new research projects. We would also be unable to maintain our implementation program. In short, while we could carry out modest activities at the reduced level, we would not be able to maximize our efforts to increase efficiency in the Government generally within our area of expertise—administrative procedures and processes. Without the resources requested in the President's budget we would be unable to carry out the activities proposed in our budget request.

In responding to this question, I would also like to point out that the Administrative Conference already has an extremely small operating budget, and will continue to have a very small budget even if we receive the modest increase requested for fiscal year 1987. There is less fat to trim in an operation of this very small scale because we are not big enough in the first place to be able to achieve savings of any size through efforts such as reductions in administrative expenses, attrition of staff, et cetera. Further, you should be aware that prior to our Gramm-Rudman cutback, we had accepted a 3-percent decrease in fiscal 1986 from fiscal 1985 by agreement with OMB.

Question. Have you achieved the 135 square foot goal? If not, why not, and what is your target date?

Answer. Yes; we have achieved the goal. In fact, the Administrative Conference was operating at the required space-efficiency level before the program was established.

U.S. TAX COURT

STATEMENT OF SAMUEL B. STERRETT, CHIEF JUDGE

ACCOMPANIED BY:
PAUL NEJELSKI, COURT ADMINISTRATOR
CHARLES S. CASAZZA, CLERK OF THE COURT

PREPARED STATEMENT

Senator ABDNOR. Next, we are going to hear from the Honorable Samuel B. Sterrett, chief judge of the U.S. Tax Court. It is nice to see you again. I think you have just gotten a sampling of the kind of questions we might be asking. I assure you, your statement, like the previous one, will be made a part of the record. All of the statements will be. Just go ahead and proceed.

[The statement follows:]

STATEMENT OF SAMUEL B. STERRETT

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you and present for your consideration the appropriation request of the United States Tax Court for fiscal year 1987.

FISCAL YEAR 1987 BUDGET REQUEST

The Tax Court's fiscal year 1987 budget request is for $25,538,000 and 339 permanent positions. This amount represents an increase of $982,000 (4.0%) over fiscal year 1986. Our request also contains 9 new positions. The Court's fiscal year 1987 budget reflects our best judgment with respect to the Court's needs for handling our pending case load. I will summarize the increase and call your attention to the fact that further justification for the specific items is contained in our budget submission.

NEW REQUIREMENTS

The Court is requesting $474,000 in new requirements. This amount includes the salaries and benefits for 9 new positions. Five positions are required for an additional Judge and staff to replace one Judge who will be assuming senior status in fiscal year 1987. Four additional positions are required in the Office of the Clerk of the Court to support the administrative functions of the Court. These positions must be added because of the increase in filings projected during fiscal year 1987. However, no new additional costs associated with travel, transportation, court reporting, communications or contract services are being requested. Under this request, the number of employees of the Court will increase 2.7% over fiscal year 1986 although the case filings are projected to increase by seven to ten percent.

An additional $400,000 is required in fiscal year 1987 to provide for the operation and maintenance of the Court's new automated docket and tracking system. This amount includes funds for software modifications, software and hardware maintenance, processing microfilm for archival and backup, operational supplies, and funds for future equipment and software purchases for system enhancements. This new automated docket and tracking system are part of the Court's efforts to manage its increased filings.

PAY ADJUSTMENTS

During fiscal year 1987, $290,000 will be required to finance promotions and within-grade salary increases for employees who will be eligible for advancement to the next step in salary.

OTHER COST ADJUSTMENTS

The Court will require $628,000 to cover other cost adjustments for fiscal year 1987. This amount includes $298,000 for annualization to allow the Court to continue staffing levels approved in prior years. The January 1986 Social Security (FICA) and Medicare Tax rate increase will require an additional $56,000. GSA rent charges are being increased by $245,000 for fiscal year 1987.

Maintenance and leasing costs for the Court's word processing equipment will be increased $23,000 during the year. An additional $6,000 is requested to continue the Judges's training program begun in fiscal year 1986 and to provide continuing training to other Tax Court employees on the new automated equipment.

ONE-TIME ADJUSTMENTS

The following items were approved as one-time adjustments in our fiscal year 1986 request and the amount of $410,000 has been reduced from our fiscal year 1987 request:

1. $100,000 for the purchase and installation of a new telephone system for the Tax Court's headquarters and field offices.
2. $100,000 for the management studies to improve the Court's operations to the public.
3. $100,000 for the purchase of additional word processing equipment.
4. $80,000 for the purchase of a high speed copy machine for reproducing the Court's opinions.
5. $30,000 for the purchase of shelving systems and furniture in the Public Files area of the Court.

FISCAL YEAR 1987 OBJECTIVES

With the advent of the Gramm-Rudman-Hollings Act, the Court will be forced to institute many changes for reducing expenses during fiscal year 1987. These will include the following and hopefully will not result in an unacceptable curtailment in the judicial services the Court performs.

1. The Court will absorb the costs associated with inflation. No additional funds are being requested in fiscal year 1987 to cover projected increased due to inflation.
2. The Court will absorb the costs associated with the GSA High Rate Geographic Areas subsistence cities and any airline increases that may be imposed at a later date.
3. No increases for travel, transportation, or printing have been requested.
4. The Court will maintain the same number of trial weeks as fiscal year 1986. However, controls and limits on the number of special sessions that the Court holds will be instituted.
5. The Court is experiencing severe difficulty in obtaining space to hold sessions in several cities. The requests for additional space for courtrooms may be withdrawn from GSA. This may cause delays in holding trials in these cities. In addition to new space, all renovations of existing assigned courtrooms will be delayed or canceled. These changes involve security measures and safety repairs such as alarm systems to marshall and guard offices and repair and replacement of torn carpets.

THE COURT'S WORKLOAD

Any discussion of the Court's workload must emphasize that at the present time the Tax Court handles approximately 95% of all substantive tax litigation, exclusive of collection actions, in the Federal courts. As the Committee knows, it is the only Court where a taxpayer can litigate his case without prior payment of a tax deficiency determined by the Internal Revenue Service.. Proceedings in the Tax Court are begun by filing a petition after the taxpayer has been sent a deficiency notice by the Commissioner of Internal Revenue. The deficiency notice procedure is one over which the Tax Court has no control. As the number of deficiency notices increase, the Court's docketed cases will increase commensurately.

In fiscal year 1970, 7,390 new cases were filed. In fiscal year 1975, the number of new cases filed was 11,213. In fiscal year 1985, 45,295 new cases were filed. Thus, over the past fifteen years the number of new cases has increased more than 500 percent, and in the last nine years it has tripled. For fiscal year 1985, the increase in new cases filed was 8% more than in fiscal year 1984.

The inventory of pending cases rose from 12,040 at the end of fiscal year 1970 to 16,448 at the end of 1975, which was a 37% increase. At the end of fiscal year 1985, the inventory of pending cases stood at 72,836, a 510% increase, or more than five times the pending case load in 1970. The pending case load has been maintained since fiscal year 1977 at approximately 150% of the number of cases filed each year.

The pending case backlog consists mostly of recently filed cases. About 80% of the regular cases which are tried are disposed of within 18 months from the date of trial. This period does not include the time for filing briefs, which usually takes from 4 to 6 months. About 98% of the small tax cases which are tried are disposed of within 9 months from the date of trial. Cases generally go to trial only when both parties indicate they are ready. In the meantime the judges are actively trying to get the parties to settle before the trial date.

In fiscal year 1977, the pending case load was 21,298, 85% regular cases, 15% small tax cases. By the end of fiscal year 1985, the pending case load had increased 242% to 72,836 -- 41% so-called shelter cases, 44% regular cases, 15% small tax cases. Small tax cases increased 256% during this time period, but a large majority of this increase can be attributed to the increase to $5,000 in fiscal year 1984 and to $10,000 in fiscal year 1985 per tax year in the statutory maximum for small tax cases. Pending regular cases increased 240%. The total pending case load increased 242% since fiscal year 1977, 51,538 cases, but it is important to note that shelter cases, approximately 30,000 cases, accounted for 58% of this increase.

THE COURT'S WORK PRODUCTION

In a continuing effort to decrease the backlog of pending cases, the Court as a whole has increased its productivity. The number of opinions written by the Court increased from 573 in 1970 to 796 in 1975 and to 2,049 in 1985. The number of cases closed by the Court increased from 6,610 in fiscal year 1970 to 8,616 in fiscal year 1975, and to 36,436 in fiscal year 1985. To a large degree, the increase in the number of cases closed reflects what appears to be a more flexible settlement policy of the Internal Revenue Service.

Of the 796 opinions written in fiscal year 1975, 525 or 66% were written in regular cases and 271 or 34% in small tax cases. Of the 2,049 opinions written in fiscal year 1985, 1,283 or 63% were written in regular cases and 766 or 37% in the small tax cases.

SMALL TAX CASE PROCEDURES

Under the small tax case procedures, which are optional with the taxpayer, trials are conducted in an informal and prompt manner. The rules of evidence are relaxed; neither party is required to file a brief; and neither party may appeal. The jurisdictional limit for the small tax case was $5,000, recently increased by Congress to $10,000, for each taxable year.

The Court currently is authorized seventeen special trial judges assigned to handle the small tax case work. They are also assigned certain types of regular cases, but in such cases their findings and opinions are reviewed and adopted or modified by a Presidentially appointed judge of the Court.

The number of cases in which the small tax case election has been made has increased steadily since the provisions became law. In fiscal year 1971, 1,349 small tax cases were filed; in fiscal year 1975, 3,290 small tax cases were filed; and in fiscal year 1985, 12,458 small tax cases were filed.

The small tax case procedures, as conceived by Congress, contemplated that the cases would be heard and disposed of promptly. Expeditious handling of these small tax cases helps maintain confidence in the efficiency and fairness of the revenue and judicial systems. Delays not only tend to undermine such confidence in the efficiency and fairness of the revenue and judicial systems but defer the availability to the Treasury of the revenue ultimately found to be owed. This is also true with respect to regular cases.

CONCLUSION

During fiscal year 1985, the amount of deficiencies ultimately determined by the Court to be owed by taxpayers was $724,746,430, or about 28 times the amount of our fiscal year 1987 budget request. The 72,836 cases pending in the Tax Court at the end of fiscal year 1985 involved deficiencies determined by the Internal Revenue Service in the total amount of $13,550,447,470. To the extent of taxes owed, the revenue ultimately involved in these cases cannot be collected until they have been heard and decided or otherwise disposed of. Delays in closing these cases deprive the Treasury of revenues which are due. To the extent that the determined tax liabilities are not in fact owed, they create financial uncertainties for corporations, businessmen, and individuals in making business, investment, and other decisions.

Since fiscal year 1977, the Court's budget has increased only 213% including amounts received because of inflation and the personnel levels have increased only 59%. The estimated number of cases filed since 1977 to 1987 has increased over 332% and the number of cases closed increased over 335% during the same time period. Thus, the productivity of the existing personnel has increased significantly over the past few years.

The Tax Court generates funds for the United States Treasury. We must continue our determined effort to narrow the gap between the cases closed and the cases filed. The Court must have adequate funds and resources to cope with the pending case load and meet future challenges. The Commissioner has notified the Court that the Internal Revenue Service has thousands of proposed deficiencies in the audit process concerning tax shelters and tax protesters. Unlike many other Government agencies with multiple programs, the Tax Court has only one program--the judicial handling of Federal tax cases. Whenever appropriations are decreased, the primary area in which the Court has any flexibility to reduce is the amount of travel it does to hear cases. If the Tax Court does not travel and hold trial sessions, the case load will continue to increase and the funds due Treasury will not become available. The Court's statute requires that sessions be held *with as little inconvenience and expense to taxpayers as is practicable* (Internal Revenue Code (Title 26 of the U. S. Code) Section 7446).

The Court would be derelict in it's duty to Congress, especially as an Article I Court, if we did not call attention to the fact that the proposed increased appropriation for the Internal Revenue Service will inevitably have the effect of increasing the number of potential filers in the Tax Court seeking a redetermination of the deficiencies determined by the IRS.

Mr. Chairman, that concludes my statement. I will be pleased to answer any questions the Committee may have.

INTRODUCTION OF ASSOCIATES

Chief Judge STERRETT. Thank you very much. It is, of course, an honor to be here. It is also my maiden voyage by myself. I was carrying Chief Judge Dawson's luggage last year, but now I am here all by myself.

On my left is Paul Nejelski, our court administrator, and on my right is Charles Casazza, clerk of the court.

BUDGET REQUEST

The court's request for fiscal 1987 is $25,538,000 and for 339 permanent positions. This represents a 4-percent increase over fiscal 1986, and an increase of nine new positions. I might say, Mr. Chairman, this is a summary of a statement that with your permission we would ask be placed in the record.

COURT CASELOAD

Obviously, we are looking to the future and in so doing we must take into account the fact that the case filings increased by 8 percent from fiscal 1984 to 1985. The precise numbers are from 42,000 filings in 1984 to over 45,000 filings in 1985.

Senator ABDNOR. May I stop you just for a second?

Chief Judge STERRETT. Yes, sir.

Senator ABDNOR. Can you hear all right?

Mr. MILLS. I can hear, yes, sir. Thank you.

Chief Judge STERRETT. These new filings left us with a total docket of 72,836 cases at the end of fiscal 1985. Our estimate of total filings in 1986 is 49,600, and we estimate that settlements will hold the number of docketed cases at the end of the fiscal year to 80,786.

With respect to 1987, we estimate 53,400 filings and a docket that will aggregate 89,000 by the end of that year. When we add into the equation the fact that we have been advised by the chief counsel of the Internal Revenue Service that we can expect the flood of tax shelter petitions to continue into fiscal 1987, some 30,000 of the aforementioned 53,000 to be exact, it is believed that a 4-percent increase in our budget is more than reasonable. I might interject here, I hope the committee will bear in mind that an increase in the budget of the Internal Revenue Service will inevitably result in more notices of deficiencies being sent out by the Internal Revenue Service with the equally inevitable consequence of more petitions being filed in the Tax Court. Since the service is prohibited from collecting the tax until the court has judicially redetermined the asserted liability, collection of additional taxes will be severely hampered if the court does not have the personnel and facilities to handle these expeditiously.

You might be interested to know that during the fiscal year 1985 the amount of deficiencies ultimately redetermined by the court to be due was approximately $725 million or about 28 times the amount of our fiscal budget request for 1987. The 73,000 cases pending in the court at the end of 1985 involved deficiencies aggregating some $13.5 billion. You might well ask what steps the court is taking to deal with our increasing caseload and how are we going to do it in a cost-effective manner.

AUTOMATION

I can assure you, sir, that we are ever conscious of the need to carry out our congressionally mandated responsibilities in the most cost-effective manner. One way is diversion to greater automation. The automation of that part of the clerk's office which is responsible for processing all the papers filed by the parties is well underway. We hope to implement the system insofar as entering new cases within the next 4 to 6 weeks.

Unfortunately, this is a situation where the manual system was not really broken. In fact, as a system it worked well. The decision to automate was dictated simply by the sheer volume of cases that the high number of filings has caused. We just simply couldn't survive if we are forced to continue to process all of this work manually.

The Tax Court will realize substantial time savings. The computer system will eliminate a number of manual steps in processing cases and automatic generation of notices and eliminate redundant data capture.

FISCAL YEAR 1987 OBJECTIVES

As judges, we recognize that we must assume our share of the responsibility for keeping our docket under control. Accordingly, we have increased the management, handling, and disposition of tax shelter cases by making earlier assignments of large related groups. We are continuing to maintain an increased number, increased from 1985, an increased number of trial sessions and the number of cases and trial hours placed on such session.

We have improved the method by which we distribute the workload between judges and special trial judges, and we are handling most of our tax protester cases, as we use that phrase, by using summary methods.

Furthermore, the number of opinions have continued to grow—for example in 1975 we wrote 796 opinions. In 1985 we wrote 2,049. In fiscal year 1985 we closed 36,000 cases and our goal, sir, for fiscal 1987, is 45,000 cases.

Mr. Chairman, I very much appreciate the opportunity of being here, sir, and obviously I will be happy to answer any questions.

GRAMM-RUDMAN-HOLLINGS REDUCTION

Senator ABDNOR. Thank you, judge. We certainly got the message that you have quite a load. I am going to ask the same question I have asked previously. How have you allocated the Gramm-Rudman-Hollings cut?

Chief Judge STERRETT. While we thought we had a fat free agency, there was some gristle there and we cut into that. And we are not going to refill some vacancies for some special trial judges. Two have left this year and we do not intend to replace them. That will be a considerable savings in dollars. We have had two special trial judges out in California. One has been assigned out there on a temporary basis. We are going to bring him home and keep him home.

Senator ABDNOR. You would have left him there if it had not been for the cut?

Chief Judge STERRETT. We were giving serious consideration to leaving him there, yes.

Senator ABDNOR. I know you talked last year about putting a man out there permanently.

Chief Judge STERRETT. Yes, sir; we are going to leave one out there. This is the second man that we brought back. Thirty percent of our caseload is in that area, and we were thinking that perhaps we could expand the workload that would be handled out there by a special trial judge for more than just a small tax case procedure, but also to include some motions work, but we will pull that back and see how much our one man out there can do.

We are stretching out our computerized docket tracking system program and we are stretching out our purchasing of word processing. We are stretching out the training of some employees in word processing. We are postponing renovation of some field courtrooms and also we are not actively soliciting more courtroom space in cities where we have a hard time borrowing space.

Senator ABDNOR. With all that, do you feel those cuts have had any adverse impact on the court's ability to handle the caseload?

Chief Judge STERRETT. In all candor, sir, I do not think so.

COURT CASELOAD

Senator ABDNOR. I respect that greatly. Your backlog has not gotten worse?

Chief Judge STERRETT. In all candor, it is getting worse, but I do not think it is attributable to the matters I have just suggested. Thirty percent of our caseload is in the tax shelter area, and it is that area that has grown so enormously over a period of time. And I think, although we expect the tax shelter cases to go up for another year or so, we do think we see the light at the end of the tunnel. By the new auditing processes of the IRS and our new management procedures, we think and pray that in about 1 year or so the backlog will start to recede. It will go up for awhile, but we expect it to recede. Already the tax protester area has been substantially improved.

The penalties that Congress authorized us to impose and which we have been imposing frequently have been a big help in cutting down the tax protester returns, those returns that challenge the constitutionality of income tax; say it violates the Northwest Ordinance, which, as I said before, sent us all to the history books.

CASELOAD INCREASE

Senator ABDNOR. Very good. There is just no doubt that funding for the IRS increases; there is a major emphasis placed, of course, on the collection of taxes. That is what we are talking about. I would not be surprised to see additional dollars go in. It is certainly one of the big requests that OMB and everyone else is bringing up. You are going to increase your caseload. You said that. Can numbers be given to provide us with some kind of an idea of correlation between the numbers and what goes on over there?

Chief Judge STERRETT. Can I submit that in writing?

Senator ABDNOR. All right. Have you been considering that in your future budgets?

Chief Judge STERRETT. Yes, sir.

[The information follows:]

IRS BUDGET INCREASE

We are informed by the Internal Revenue Service that the court can expect 2.5 petitions for each new auditor or revenue agent that IRS may hire in the future.

ADDITIONAL POSITIONS

Senator ABDNOR. I see I did not even have to tell you. Now, you are asking for an increase of nine new positions?

Chief Judge STERRETT. Yes, sir; particularly in the docket room. A lot of them will be in the docket room to handle the petitions. Just the sheer volume of pieces of paper that come into our docket room is petitions.

Senator ABDNOR. Why do you not put that in the record. Submit for the record how you are going to use those nine positions.

Chief Judge STERRETT. Yes, sir; I would be happy to do that.

[The information follows:]

ADDITIONAL POSITIONS

In fiscal year 1987, the court is requesting nine new positions. Five positions are required for an additional judge and staff to replace one judge who will be assuming senior status in fiscal year 1987. The additional four positions are required in the clerk of the court office to support the administrative functions of the court such as admissions, appellate, calendar, docket, petitions, and trial clerks. These administrative positions are required because of the increase in filings projected for fiscal year 1987.

INTERNAL REVENUE SERVICE BUDGET INCREASE

Senator ABDNOR. For the record, we will have some questions for you that you can respond to. The IRS is seeking a large increase in fiscal 1987 and the President's budget indicates they will seek additional funding in 1988 and 1989 to enhance collections. It would seem to me that your caseload will increase correspondingly to the IRS collection initiative. Have you discussed the increased needs of the court with OMB?

Chief Judge STERRETT. No, sir; we have not. Perhaps we should, Mr. Chairman.

Senator ABDNOR. They are going to be asking for 2,500 more people in 1988 and 1989.

Chief Judge STERRETT. There is certainly a clear correlation between the number of audits and the number of statutory notices and the number of petitions.

Senator ABDNOR. We have been joined by Senator Mattingly. We appreciate having you on this committee. You bring a lot to it.

TAX REFORM

Senator MATTINGLY. Thank you, Mr. Chairman. The change in tax laws beginning this year will probably make you busier, will it not?

Chief Judge STERRETT. Yes, sir; first of all, we have to learn about it and then we will have to decide.

Senator MATTINGLY. I saw somebody the other day who made the comment that H.R. 3838 was going to make work for lawyers and CPA's yet unborn.

Chief Judge STERRETT. The tax section are a group of happy people.

TAX AMNESTY

Senator MATTINGLY. Hopefully, we can come to the rescue in the Senate.

Let me ask you in reference to tax amnesty, which is an idea that is floating around, that I do not really think that much of. I wonder if you could give me some idea of what impact that might have on our Nation's tax system. Do you have any ideas of what may happen in reference to revenues or on your case workload?

Chief Judge STERRETT. Well, I have a personal view on the merits of the proposal, and my personal views are apparently the same as yours, sir. I have been in the tax business since 1950, mostly as a private practitioner, and I think it would hurt enforcement. The analogy that is being made to the States, in my humble opinion, is not an accurate one because the States do not have the enforcement policies that the IRS does.

So any dollar that someone comes in voluntarily, so to speak, and gives is a dollar they would not have gotten. The dollar the Federal taxpayer brings in, maybe a special agent would have been knocking on the door 5 minutes later and asking for it. Speaking personally, I think it is a bad idea.

Senator Mattingly. Do you not think it would have an impact on people who complied with the law?

Chief Judge Sterrett. Yes; I do. I think it would have an adverse effect. I think it might, as a phrase my father used to use, make someone feel like a chump.

ADDITIONAL COMMITTEE QUESTIONS

Senator Mattingly. Mr. Chairman, that is all the questions I have. This gives me more canon fodder to come out against tax amnesty.

Senator Abdnor. Anything else?

Mr. Mills. No, sir.

Senator Abdnor. We will have some for the record. Judge, we appreciate you coming

Chief Judge Sterrett. Thank you.

Senator Abdnor. Thank you very much.

[The following questions were not asked at the hearing but were submitted to the court for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

JUDGES' POSITIONS

Senator ABDNOR. Are all of your full time Judge and Special Trial Judge positions filled at the present time?

Chief Judge STERRETT. Currently the Court has the 19 authorized number of Presidentially appointed Judges, and fifteen of the seventeen authorized Special Trial Judges. We recently had two Special Trial Judges retire.

JUDGES' WORKLOAD

Senator ABDNOR. Could you give the Committee a brief outline of what a typical caseload would be for the judges at the Court?

Chief Judge STERRETT. Since it is not feasible to assign cases to Judges when they are first filed because we hear cases in over 80 cities, Judges are assigned trial sessions in the cities of either one or two week duration. Each Judge is assigned from 8 to 10 trial sessions each year. There may be up to 200 cases calendared for trial on each of these sessions which normally involve extraordinary trial time. The caseload of the Judges can vary greatly depending on the number of related cases that may be pending with respect to a common issue. We speculate that the caseload will be even higher in fiscal year 1987.

COURT CASELOAD

Senator ABDNOR. Has the caseload increase been considered in planning for future budgets?

Chief Judge STERRETT. Yes, the Court has requested nine new positions in the FY 1987 budget request to cope with the increasing caseload. In response to the Gramm-Rudman-Hollings Act, the Court is only requesting these new positions for the last quarter of the fiscal year, the one that the Court experiences its greatest number of new filings.

LOS ANGELES OFFICE

Senator ABDNOR. Last year you discussed the possibility of locating a Judge permanently in California. Have you been able to do this?

Chief Judge STERRETT. Yes, the Court opened its Westwood, California facility on January 2, 1985. A special trial judge is stationed there full-time and a second special trial judge has been stationed there temporarily.

Senator ABDNOR. What will the advantage be?

Chief Judge STERRETT. The assigned special trial judges are hearing all the small tax cases in the Los Angeles area. At a later date, we plan to have them handle many of the regular cases where the amount is $10,000 or less as well as interlocutory motions. Petitioners in Los Angeles are receiving expeditious hearings, large numbers of cases have been handled, and high quality standards have been maintained. The first thirteen months of operations have seen 2,525 cases disposed of by the Los Angeles operation.

GRAMM-RUDMAN-HOLLINGS ACT

Senator ABDNOR. Your request for FY 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen? Would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

Chief Judge STERRETT. Preparation of the Court's budget for fiscal year 1987 began before the Gramm-Rudman-Hollings Act became law. Following enactment of the law, the Court reviewed the budget request with the new law in mind and made many reductions to the fiscal year 1987 request. These reductions included absorbing cost increase due to inflation, telecommunication increases, travel and printing increases. In other words, our fiscal year request of $25,538,000 does take the Gramm-Rudman-Hollings sequestration of $1,056,000 in fiscal year 1986. Any further reduction will require the Court to review where reductions can be made such as reducing trial sessions and special trial sessions.

OFFICE SPACE

Senator ABDNOR. Have you reached the 135 square foot goal? If not, why and what is your target date?

Chief Judge STERRETT. No, the Court is not subject to this GSA regulation. The Court is guided by the regulations published by the Administrative Office of the U. S. Courts.

Senator ABDNOR. Have you gotten the extra space you have been seeking?

Chief Judge STERRETT. Yes, the Court has moved its Special Trial Judges into the new office space last year at 633 Third Street, N.W..

AUTOMATION

Senator ABDNOR. What is the status of your automation effort?

Chief Judge STERRETT. The Court's automation is well under way. We hope to implement the system, insofar as entering new cases, within the next four to six weeks. The Court will realize substantial time savings. The computer system will eliminate a number of manual steps in processing cases, automatic generation of notices, and eliminate redundant data capture. In addition, the Court will have more rapid access to data allowing for more responses to inquires for case information. The system will provide a vital management function for the Court and will provide statistics not readily available at the present time. With the number of filings increasing each year, this new automated information retrieval system is essential for the Court to operate efficiently.

QUESTION SUBMITTED BY SENATOR DENNIS DECONCINI

GRACE COMMISSION RECOMMENDATIONS

Senator DeCONCINI. Judge Sterrett, as you may know, three members of this Subcommittee are members of the newly formed Senate Grace Commission Caucus (Proxmire, DeConcini, Co-Chairman, and Mattingly). One of the Grace Commission recommendations that the Caucus is actively pursuing is Treasury Recommendation No. 3. This proposal calls for the establishment of a decentralized appellate tax board, consisting of about 75 administrative law judges in cities around the country to resolve all tax cases involving deficiencies of $10,000 or less. It is our hope that this would free-up valuable Tax Court time and staff and accelerate both assessments and payments of taxes into the Treasury. It is estimated by the Grace Commission that this plan could save as much as $1 billion in the first full year of operation.

Would you support the formation of this appellate tax board to take some of the burden off of the Tax Court dockets? If not, why not?

Chief Judge STERRETT. No, I do not support the formation of an appellate tax board because the idea is not cost effective. As of September 30, 1985 the Tax Court's small tax cases pending deficiencies only amounted to $35,448,950. This figure is far from the proposed $1 billion savings that the Grace Commissions states that could be saved during the first year of operations. The proposed cost of 75 administrative law judges by the Grace Commission did not include the costs associated with secretarial support, law clerk support, nor did it include benefits or other costs such as rent, communications, reporting and travel. I base this on our budget request for fiscal year 1987.

As Chief Judge of the Tax Court, I feel very strongly that the small taxpayer who files with the Court is being treated not only fairly but very expeditiously in having their day in Court. As a matter of fact, small tax cases are being heard currently. I think we can move the cases where the deficiency amounts are $10,000 or less with the staffing arrangements that we have. I think the Grace Commission recommendation would cost the taxpayers a lot more money if it is acted upon. It just would not be as efficient or as cost effective as the current system.

COMMITTEE FOR PURCHASE FROM THE BLIND AND OTHER SEVERELY HANDICAPPED

STATEMENT OF FRANK GEARDE, JR., CHAIRMAN

ACCOMPANIED BY CHARLES W. FLETCHER, EXECUTIVE DIRECTOR

PREPARED STATEMENT

Senator ABDNOR. Our next witness is going to Mr. Frank Gearde, Jr., Chairman of the Committee for the Blind and the Other Severely Handicapped. He will be accompanied by Mr. Charles Fletcher, the Executive Director of the committee. We welcome you back to the committee and ask you to do like the other witness: summarize and your whole statement will be made a part of the record.

[The statement follows:]

STATEMENT OF FRANK GEARDE, JR.

Mr. Chairman, we are pleased to appear here today to present the appropriations request of the Committee for Purchase from the Blind and Other Severely Handicapped for fiscal year 1987.

This committee was created by the Javits-Wagner-O'Day Act (Public Law 92–28) in 1971. The committee is the successor to the Committee on Purchases of Blind-Made Products established by the Wagner-O'Day Act of 1938. Its purpose is to increase employment opportunities for blind and other severely handicapped, and whenever possible, to prepare these individuals to engage in normal competitive employment. The committee's primary means for achieving its objective is to direct the Government's procurement of selected commodities and services to qualified workshops serving the blind and other severely handicapped.

The 15 members on the committee are appointed by the President. Eleven members represent various Government agencies and four are private citizens who are conversant with the problems of employing blind and other severely handicapped persons.

Under the act, the committee has the responsibility for determining which products and services the Federal Government buys are suitable for provision by qualified workshops serving the blind and other severely handicapped. The committee establishes the prices which the Government must pay for those commodities and services.

The committee has a full-time staff of 12 persons to assist in the implementation of the program. The staff is responsible for developing recommendations and proposals for the consideration of the committee. Operationally, it supervises the selection and assignment of new commodities and services; assists in establishing the fair market price and reviewing price changes; verifies the qualifications and monitors the performance of workshops; and serves as a vital link between the workshops and the Federal Government in expanding the program and resolving production problems. In addition, the staff handles all of the administrative functions for the committee such as developing policies and procedures, initiating and responding to correspondence, preparing the committee's budget, and performing all the functions required of an independent Government agency.

During fiscal year 1985, the committee continued its progress in expanding the benefits of the Javits-Wagner-O'Day Act to increasing numbers of blind and other severely handicapped individuals.

Workshop sales to the Federal Government under the committee's program during fiscal year 1985 were over $253 million. In addition, sales through the Military Resale Program were $15 million, for a total of about $268 million under this program. This represents an increase of $18 million over the total workshop sales of $250 million in fiscal year 1984.

Blind workshop sales, including those through the Military Resale Program, increased from $165 million in fiscal year 1984 to over $172 million in the past year.

Government sales by other severely handicapped workshops under this program were $95 million, an increase of $10 million over fiscal year 1984.

During the past year, the committee approved the addition of 50 commodities and 65 services to the procurement list with a total annual value of $35 million. These additions created new jobs for over 1,000 blind and other severely handicapped individuals.

As of September 30, 1985, there were 318 blind and other severely handicapped workshops authorized to produce products or provide services for the Federal Government under the committee's program, a net increase of 28 over the year before. This trend is expected to continue in fiscal years 1986 and 1987 with a commensurate increase in the workload on the committee staff.

The committee staff made 158 visits to workshops in fiscal year 1985 to ensure their compliance with the act and the committee's regulations and to resolve production problems in producing commodities or providing services under the act. We hope we will be able to make about 150 staff visits to workshops in fiscal year 1986 and about 165 in fiscal year 1987.

Our appropriation request for fiscal year 1987 is for $778,000. This is an increase of $48,000 over the appropriation for fiscal year 1986. The largest increases are in the pay of personnel, standard level user charge, and travel.

The committee's budget request for fiscal year 1987 provides the resources required by the committee to carry out its responsibilities for expanding employment opportunities for the blind and other severely handicapped of this Nation.

By Senate Report 99–133, this committee is required to submit certain information on the employment of blind and other severely handicapped in the central nonprofit agencies and in the workshops participating in the committee's program.

As I indicated to you in my letter of October 22, 1985, the reports which the committee receives annually from the workshops participating in the committee's program do not provide a basis for comparing the positions, pay, and benefits of blind with those of nonblind individuals and for making similar comparisons for severely handicapped and nonhandicapped persons. We have summarized the data submitted to us by the workshops on employment, earnings, and wages for fiscal year 1985 and have provided a copy of the report to your staff.

The central nonprofit agencies have submitted information to the committee on the employment of blind and handicapped persons on their staffs using the definitions established by the Government for reporting such information. Those reports indicate that for the National Industries for the Blind [NIB] of 91 employees, 58 reported no disability, 19 reported being disabled, and 13 chose not to have their disability status recorded. Thus, over 20 percent of NIB's staff is disabled. Of the 19 reporting a disability, 8 involved blindness or visual impairments. The report for the National Industries for the Severely Handicapped [NISH] shows that out of 76 employees, 22 reported being disabled. This represents about 29 percent of the NISH staff.

With regard to this committee's review of the fee which participating workshops return to their central nonprofit agencies, we have provided to your staff copies of the documents relating to this committee's most recent review of the adequacy of the central nonprofit agency fee, the reports submitted to the committee by NIB and NISH on their major programs and activities (including their audited financial statements) for fiscal year 1985 and their reports of planned major activities and budgets for fiscal year 1986.

BUDGET SUMMARY

Mr. GEARDE. Thank you, Mr. Chairman. Like the gentlemen before me, this is also my maiden voyage, and I hope it is not my last.

Senator ABDNOR. I am sure it will not be.

Mr. GEARDE. I would like to make just a few brief remarks, if I may.

In fiscal year 1985 the committee continued its progress in expanding the benefits of the Javits-Wagner-O'Day Act to increasing numbers of blind and other severely handicapped. The details of our progress are contained in my prepared statement. In fiscal year 1985 over 15,500 blind and other severely handicapped workers were employed under the committee's program.

The committee's appropriation for fiscal year 1986 was for $730,000. Our request for fiscal year 1987 is for $778,000, an increase of $48,000. The largest increases were in personnel costs, standard level user charges, and travel. Our budget request for fiscal year 1987 represents an austere level of funding for the committee in carrying out its responsibilities for expanding employment opportunities for the Nation's blind and otber severely handicapped.

We have addressed the reports required by Senate Report 99–133 in my prepared statement. We have provided copies of the detailed information to your staff.

Thank you, Mr. Chairman. We would be happy to answer any questions that you may have on the details of our budget or any of the other information that we have submitted.

IMPACT OF GRAMM-RUDMAN

Senator ABDNOR. Thank you for a brief and concise report. We will make your entire statement a part of the record. Like I have done with the two previous testimonies, could you tell us how you handled the Gramm-Rudman cuts for the record. You can provide us with a more detailed account.

Mr. FLETCHER. Of the $31,000, about $15,000 will be out of pay and benefits. Fortunately or unfortunately, about the beginning of the year one of my price analysts took a job with another agency and we have not filled that position. This has resulted in somewhat of a backlog in our pricing actions coming in from the workshops in price changes and in new additions to the procurement list.

We have also cut back on the number of committee meetings from the planned 10 or 11 to 8, which will reduce the pay and the travel for the committee members. We have reduced staff inspections of the workshops by about 10 percent. And we have delayed or deferred a number of other expenditures wherever possible.

LEGAL COSTS

Senator ABDNOR. Thank you. We will get more details when you have time. Now, we seem to have a lot of litigation these days. It appears to be something of a phenomenon. The committee is concerned. Would you briefly indicate what the basis for current cases are, how much of your budget do you attribute to legal cases, how does this compare with your past years, and is this a growing trend, and if it is, what are we going to do about it.

Mr. FLETCHER. We have had to reprogram funds over those which the Congress approved last year into other services for legal support from GSA. The General Services Administration provides general counsel service for the committee. Legal costs increased by about $20,000 which has increased GSA support costs.

This is reflected in an increase in that obligation area. We have an appeal now pending on a lawsuit which we won concerning the addition of seven medal and medal sets to the procurement list. These are military decorations which are made by a handicapped workshop in Pennsylvania.

The district court upheld the committee's position and the committee's decision. The only appeal was as to whether or not the notice which we filed in the Federal Register, which is a technical matter, was sufficiently explanatory of the basis for the committee's decision.

Arguments were heard on March 3, but we do not have a decision from the appeals court.

We were also sued 1 year ago by one of the handicapped agencies with regard to the exercise or the application of the blind priority. The Javits-Wagner-O'Day Act gives the blind priority over the other severely handicapped with regard to the production of commodities. In that suit again the committee's position was upheld. The court directed the committee to do something it was already doing, that was to review the time periods which the blind have to actually waive or exercise the priority. The plaintiff had asked for a reduction from 60 days to 30 days in the time for the blind to exercise the priority, and with respect to the time that a blind workshop would have to develop the item to add it to the procurement list, a reduction from 9 months to 60 days.

Acceptance of the proposed time that would probably have foreclosed most blind workshops being able to develop an item in time to get it on the procurement list, and it would have made the exercise of the blind priority a matter of futility. Incidentally, this action considering the adjustment of those times is being heard at the committee meeting tomorrow to determine whether or not those times should be changed and if so, to what extent.

Senator ABDNOR. Do you think it is going to get worse?

Mr. GEARDE. I do not know what the committee members are going to decide. I think that the committee should not establish time limits which would make the blind priority ineffective. So I feel they will go along with the present time with some minor modifications.

Senator ABDNOR. Senator Mattingly?

Senator MATTINGLY. I have no questions.

COMMITTEE PROCEDURES

Senator ABDNOR. Would you briefly outline the process a product producer must go through to get on the committee's list.

Mr. FLETCHER. Basically, there are two steps. One has to do with the qualification of the workshop. A workshop, if it is not already producing an item for the Government and has already submitted its papers to us, must submit its articles of incorporation and bylaws, or its organization papers if it is a State-controlled activity, to show that it is a nonprofit agency serving the blind, in the case of a blind workshop, or serving the other severely handicapped. That establishes its nonprofit status.

When the workshop submits a proposed addition to the procurement list—that is the central nonprofit agency presents it to us in their name—they must propose a fair market price. At that time we publish the notice in the Federal Register of the proposed addition to permit comments from interested parties. And we normally ask the procuring activity, the General Services Administration or the Defense Department, to inspect the workshop to determine that they are capable of producing the product or providing the service in accordance with Government specifications.

If all of those are favorable, they then submit a justification to the committee requesting the addition of the item to the procurement list. At that point my staff reviews all of the documents, reviews any comments, and submits to the committee any comments we have received. We give the committee an independent analysis of the industry impact on that firm based on data which, we have received either from Government agencies on their sales or from the Dun & Bradstreet reports to which we are a subscriber. All of that information, together with my independent analysis of industry impact, is presented to the committee for a decision. When the committee has reached a decision we then republish the notice in the Federal Register which announces the committee's decision and a notice is sent from my office to the procuring activity directing it to begin procurement of the item from the workshop at the end of the current contract.

INCREASE FOR RENT

Senator ABDNOR. Again with the SLUC; do you need more space?

Mr. FLETCHER. No; it is exactly the same amount of space. For the past 4 or 5 years we have had the same SLUC rate. This represents an increase in the rate to $19.38 per square foot for the 2,740 square feet we occupy.

Senator ABDNOR. What was it before?

Mr. FLETCHER. It was $17 and some cents. It has stayed at that level for at least the 3 years we have been in the present building.

Senator ABDNOR. You have a request for $6000 for special personal service payments. What is that?

Mr. FLETCHER. Basically that is to provide for money in our budget to cover any request for GSA to audit one of our workshops or for the

Defense Audit Agency to audit a workshop or we could request another agency to provide other than the normal support we get from GSA to assist us in implementing the program.

Senator ABDNOR. Have you done that for quite awhile?

Mr. FLETCHER. We have not had to use it for the last several years.

WORKSHOP INSPECTIONS

Senator ABDNOR. Just quickly, inspection of workshops is very important. How many workshops are there and how many can you get around to do? What do you go through?

Mr. FLETCHER. Basically we had some 318 workshops in the program at the end of last year. That number has now increased slightly. We try to inspect each new workshop within 6 months after it begins production, to orient them on what they are supposed to be doing, the reports they are supposed to be giving us in order to make sure that they are meeting the requirements of the law and the regulations.

We try to reinspect each workshop every 2 years. We have added, on the average, about 20 workshops each year. That requires 20 inspections plus one-half of the other 320, or 160 reinspections. We are running a little bit behind schedule. We have programmed 165 inspections for fiscal year 1987. We are now about 3 to 4 months behind the 2-year cycle. In other words, we are now reinspecting workshops about every 28 to 30 months.

We will just maintain that schedule under our budget for 1987.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Gentlemen, I think that is all we need to ask you now. I thank you very much for coming today. I know we will ask you questions for the record. We will be happy to hear from you when that time comes. Thank you very much. We have a vote on. Dave, if you do not mind, we will hold off a bit. We will be right back.

[A brief recess was taken.]

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR DENNIS DECONCINI

Question 1: Why is the information gathered by central nonprofit agencies, in exercising authority delegated to them by the Committee, not made available to the public even though the functions performed by the CNAs derive from the Committee's regulations? Why does the Committee not require the CNAs to make that information available to the public, as it would be if gathered by the Committee itself?

Answer: The Committee has delegated none of its authority contained in the Javits-Wagner-O'Day Act to the central nonprofit agencies. Under the Committee's regulations the central nonprofit agencies are responsible for monitoring the preformance of their participating workshops, for assisting workshops to qualify to participate in the Committee's program and to meet the production requirements of the Government, and for providing the information required by the Committee on the qualification and performance of their workshops.

By law the Committee is responsible for determining a workshop's qualification and compliance with the requirements of the Act based on the information provided to it from a variety of sources. The United States District Court for the Eastern District of Virginia has held that the central nonprofit agencies are not subject to the Federal Advisory Committee Act. In view of their status as private nonprofit agencies, it is questionable if the Committee has the authority to require the central nonprofit agencies to make the information from their files available to the public under the Freedom of Information Act.

Any information which is pertinent to a Committee decision regarding a workshop's qualification, the suitability of a product or service for addition to the Procurement List, and all other aspects of the Committee's administration of its program are maintained in the Committee's files and is thus available to the public under the Freedom of Information Act. Small businesses participating in proceedings before the Committee have been able to obtain vast quantities of documents from the Committee's files on every aspect of its operations. One law firm, Trilling and Kennedy of Washington, D.C., representing a number of small businesses, has obtained thousands of pages of documents from the Committee's files during the past two years.

In 1984, Trilling and Kennedy represented HLI Lordship Industries, Inc., Hauppauge, New York, in a law suit in the United States District Court for the Eastern District of Virginia challenging a Committee action adding seven medals and medal sets to the Procurement List. Prior to filing the suit, Trilling and Kennedy submitted numerous requests for documents under the Freedom of Information Act. The Committee provided over 4,000 pages of documents in response to those requests and to interrogatories and requests for production of documents filed by the plaintifff. In calendar year 1985 alone the Committee provided 2,280 pages of documents to Trilling and Kennedy in response to over 40 requests which they submitted under the Freedom of Information Act. During the first three months of calendar year 1986, they have submitted 28 additional request for documents under the Freedom of Information Act which have required the reproduction of nearly 700 pages of material. Since each request usually requires a thorough search of the Committee's records to identify the documents, extracting the documents from the file, reproducing them, and then replacing them in the appropriate file, a substantial amount of the time and effort of the Committee's staff of 12 persons has had to be diverted to this activity.

Using the documents which the Committee has provided, Trilling and Kennedy have filed lengthy objections to a number of proposed actions before the Committee challenging nearly every aspect of each proposal. Since the Committee staff must address each point which they raise, whatever its validity, these objections have resulted in a further diversion of the Committee staff's efforts and resources.

Question 2: With regard to the Committee's consideration of the adverse impact on private businesses, does the Committee give any consideration to firms other than "the current or most recent contractor" for an item proposed for addition to the Procurement List? If a firm has been a regular bidder for a particular item for several years and has obtained awards of contracts for the item, would that contractor not be adversely affected by addition of the item to the Procurement List for permanent procurement from the workshop, even if the firm did not hold the current or most recent contract?

Answer: The Committee members consider all of the information made available to them in determining the possible impact of the addition of a commodity or service to the Procurement List. However, in evaluating impact, as indicated in its regulations, the Committee gives primary consideration to the impact on the current most recent contractor as that firm would be the one most directly impacted if it is added to the Procurement List. Since the unsuccessful bidders to the Government for the item involved do not have the benefit of the sales to the Government from that contract, the primary impact on them is the loss of the opportunity to compete for that business in the future.

Question 3: In evaluating the impact of a proposed action on a commercial firm, does the Committee give any consideration to the possible effect which its action might have on that firm's ability to provide job opportunities for members of minority groups? If so, how does the Committee evaluate such a situation?

Answer: As indicated in the answer to the question above, the Committee considers all of the information available to it. The workshops participating in the Committee's program also provide employment opportunities for minority groups. Their success in this regard is demonstrated by the fact that where a workshop is located in an area with a significant minority population that minority group's representation in the workshop's blind or other severely handicapped workers generally exceeds the ratio in the local area to a considerable degree.

Question 4: In evaluating the impact of a proposed action on a commercial firm, does the Committee give any weight to evidence that its action would require the commercial firm to lay off employees in labor surplus areas? If so, how does the Committee evaluate such evidence?

Answer: Each Committee member takes into consideration the information provided when a commercial firm is located in a labor surplus area. They must balance the benefit to the blind or other severely handicapped of adding the item to the Procurement List against the possible adverse impact to the commercial firm's employees, recognizing that the unemployment rate for severely handicapped is among the highest of any group in the nation's population.

Question 5: With regard to the Committee's consideration of the cumulative impact of "recent Committee actions," how recent must a prior action be for it to receive consideration under this regulation?

Answer: The cumulative impact of "recent Committee actions" is determined by adding the possible impact of the proposed action to the value of the loss of business for that firm due to additions to the Procurement List during the prior three years. In addition, the Committee staff normally provides data on the possible impact on that firm of any earlier actions by the Committee. Thus, the Committee is given a complete picture of the impact on that firm's sales since the first time the firm was impacted by a Committee action.

Question 6: When an item is proposed for addition to the Procurement List for which the workshop is already the current or most recent contractor, is the "fair market price" established by the Committee the same as the award price at which the workshop currently provides the item to the government? If the workshop is already providing the item to the government at a certain price, is there any justification for increasing that price merely because the item is being added to the Procurement List?

Answer: When a workshop has a competitive contract for an item it is proposing to add to the Procurement List, the Committee has established different procedures for establishing the fair market price for that item from the procedures used when the item is being or has been supplied by a commercial contractor. When a workshop is the current contractor, the price is established using one-half of the differential between the median bid and the award price rather than using the normal procedure where the median bid is used to establish the price. This results in a price which is generally between 5% and 8% above the workshop's prior contract price. However, in those cases the actual increase in the return to the workshops is actually between 1% and 3% after it provides the 4% fee to the central nonprofit agency.

Under the Committee's Act, the workshops are entitled to a "fair market price" for items on the Procurement List and, simply because a workshop is the current contractor for the item, it is not considered proper to force it, if the item is added to the Procurement List, to provide the item at or below its current contract price.

Question 7: Since the purpose of the Javits-Wagner-O'Day Act is to provide increased employment opportunities for blind and handicapped persons, does the Committee give consideration to evidence that the current or most recent contractor provides jobs for blind and handicapped persons, either directly or through subcontracts to sheltered workshops or other institutional facilities? Does the Committee give any consideration to evidence that such employment opportunities provided by the current contractor would be reduced as a result of the addition of the item in question to the Procurement List?

Answer: Yes. However, the work being provided under the Committee's program is for "severely handicapped" persons who, by definition under the Act, are unable, due to the severity of their physical or mental disability, to hold a job in the competitive labor market. Most handicapped workers in industry are generally able to produce at or near the rates of their non-handicapped co-workers. The Committee has disapproved a proposed addition to the Procurement List where a significant portion of the commercial contractor's production of the item was subcontracted to a sheltered workshop. However, it appears, at times, that current commercial contractors exagerate the possible impact on their handicapped workers. For example, one firm threatened to fire 5 handicapped workers and a handicapped supervisor, if the Committee added the item it had been producing to the Procurement List. The workshop which requested the addition of the item to the Procurement List planned to do the complete production of the item with just over 1 man-year of blind labor at 75% productivity.

Question 8: With regard to the benefits actually received by blind and handicapped workers as a result of additions to the Procurement List during the most recent fiscal year, how many federal procurement dollars will be expended in order to provide one employment position for a blind or handicapped worker? Of that amount, how much will actually be paid to the blind or handicapped worker? What are the comparable figures for the Procurement List overall?

Answer: During FY 1985, the value of additions to the Procurement List was about $35 million and provided full-time jobs for just over 1,000 blind or other severely handicapped workers. Thus, the average value per job was about $35,000 each.

The Committee has no data on the proportion of that amount which would be paid in wages.

The total sales by workshops to the Government under the Committee's program in FY 1985 were $268 million. Those sales provided full-time employment to about 5,790 blind or other severely handicapped persons. Thus, the average value per full-time job was about $46,000 each. Included in that figure were average annual wages paid per full-time job of over $7,000.

Question 9: Are there any requirements of the Committee which would prevent a workshop from obtaining the addition of an item to the Procurement List and then subcontracting to a commercial firm the production of most of the components of the item, leaving only the final assembly to be performed in the workshop? Does the Committee require the workshop to "produce" commodities added to the Procurement List and, if so, how does it interpret and implement that requirement?

Answer: Yes. At the time it considers the proposal to add an item to the Procurement List, the Committee reviews the operations which a workshop plans to perform in-house as well as any operations which it plans to subcontract out. The latter are usually limited to those types of operations which require special skills or equipment not normally found in a workshop. In the production of commodities on the Procurement List, a number of factors are considered in determining whether a workshop will buy a component or produce it in-house. Some of these are: (1) will the extent of in-house operations meet the requirements of the Committee's regulations regarding production; (2) what is the practice in similar commercial firms, but not necessarily the current contractor; (3) how many blind or other severely handicapped direct labor jobs would be added by producing a component in-house rather than buying it from an outside source.

With respect to the medals and medal sets which were the subject of the law suit by HLI Lordship Industries, Inc., mentioned above, the workshop in that instance clearly exceeded any reasonable standard in the production of these items.

Question 10: If a workshop does subcontract a substantial amount of the work in producing a procurement List item, does the Committee place any conditions on the selection of a subcontractor? Does the current or most recent contractor receive any favorable treatment in selection of a subcontractor?

Does the Committee require that a subcontractor be selected competitively, and if so, how is that requirement enforced?

Answer: As a matter of general practice, workshops do not subcontract out substantial amounts of work in the production of a commodity, but rather they try to maximize the amount of blind or other severely handicapped labor performed in the workshop on that production. For commodities on the Procurement List the Committee requires workshops to obtain the raw materials and components used in producing those items from a reliable source at the lowest cost. The Committee does not require or expect the workshop to provide favorable treatment to the current or most recent contractor in selecting its suppliers of raw materials and components. Workshops are encouraged to provide the current or most recent contractor an opportunity to compete in providing raw materials or components.

[CLERK'S NOTE.—Subsequent to the hearing the subcommittee has received a letter from Stanley H. Hackett, attorney at law, Troutman, Sanders, Lockerman & Ashmore, which will be placed in the record at this point.]

LETTER FROM STANLEY H. HACKETT, ATTORNEY AT LAW, TROUTMAN, SANDERS, LOCKERMAN & ASHMORE

March 7, 1986

The Honorable James Abdnor
Chairman
Subcommittee on Treasury, Postal Service
& General Government
Committee on Appropriations
Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

We understand that representatives of the Committee for Purchase from the Blind and Other Severely Handicapped (the "Committee"), will be appearing before your Subcommittee on March 12, 1986, in connection with the Committee's requested appropriation for the next fiscal year. On behalf of our client, Jebco, Inc. of Warrenton, Georgia, we would appreciate your consideration of the following comments as you review the requested appropriation.

Jebco is a contract manufacturer of metal office furniture and equipment principally for sale to the General Services Administration, the Department of Defense and the U. S. Postal Service. Jebco is located in Warren County, Georgia, which has been designated as a labor surplus area by the U. S. Department of Labor. Jebco currently has 195 employees, 65% of whom are minorities. It has employees over the age of 65 and other employees who are physically handicapped. Jebco is one of the few industrial employers in the surrounding 5 county area. It is a small business under any definition of the term, including the operative SBA definition for its industry classification (fewer than 500 employees).

Over the years, a substantial portion of Jebco's sales have been sales of various types of metal bookcases and metal tables to GSA. For example, Jebco used to compete for, and often won, contracts to provide National Stock No. 1621 (metal bookcase, 2 shelves, color: parchment[1]) and Item No. 9823 (metal bookcase, 2 shelves, color: black).* Currently it is producing under the most recent GSA solicitation Item No. 9821 (metal bookcase, 3 shelves, laminated top, color: black) and Item No. 9822 (metal bookcase, 3 shelves, laminated top, color: parchment). This latter contract, which expires in October, 1986, presently constitutes approximately 40% of Jebco's total revenues.

Recently, it came to Jebco's attention that the Committee was preparing, pursuant to the Javits-Wagner-O'Day Act (JWOD), to withdraw from the competitive procurement system, and to award to a tax exempt manufacturing facility owned by the State of Tennessee and operated by the Knox County Association for Retarded Citizens, Knoxville, Tennessee, the contract to supply all future government requirements for Item No. 9821. As noted, Jebco is the current supplier of this item to the GSA, having successfully competed for and procured the contract. Jebco's contract expires in October, 1986. Over the last twelve month period, this item alone has accounted for approximately 15% of Jebco's total sales. On investigation, Jebco learned that the same Knox County manufacturing facility had initiated proceedings before the Committee to remove from competitive procurement Item No. 9822 and Item No. 1997. Jebco has the current contract for Item 9822, and in the most recent twelve months, Item No. 9822 has accounted for approximately 25% of Jebco's total sales. Jebco has produced Item No. 1997 in the past, but was not the successful bidder in the most recent procurement.

On further investigation, Jebco learned that the same Knox County manufacturing facility is currently the sole supplier to GSA of a metal bookcase (Item No. 1621) and a metal bookcase (Item No. 9823). As noted, Jebco used to bid, and has successfully won, the contract for these items in the past. Since these items have not been on the GSA procurement list for several years, Jebco has been under the impression that these items were simply no longer being acquired by GSA. However, it now appears that these items are being acquired by GSA, but, pursuant to the JWOD are purchased solely from the Knox County manufacturing facility.

To summarize, Jebco learned that the Knox County manufacturing facility (1) is now the sole supplier to the government of two bookcases that Jebco used to compete for; (2) was attempting to be the sole supplier of another bookcase which Jebco has competed for and produced in the past; and (3) was attempting to be the sole supplier of two other bookcases which currently account for 40% of Jebco's sales.

Jebco also learned that the following items are now produced solely by other tax exempt manufacturing facilities pursuant to contracts obtained under the JWOD: Item Nos. 0448, 0454, 2044, 2045, 2046, and 2047, all constituting various types of contemporary steel tables. Jebco used to compete for and produce Items Nos. 0448, 0454, 2044 and 2045, but they disappeared from the competitive procurement list several years ago. Again, Jebco was under the impression that these items simply were no longer being acquired by GSA. It has now learned that they are being acquired, but are being acquired only from tax exempt manufacturing facilities under the JWOD.

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[1] For convenience, reference will be made only to the last four digits of National Stock Numbers.

On the most recent GSA procurement list for metal office furniture, seventy-nine items are listed. Total volume is probably in the eighty million dollar range. Of these items, fourteen items constituted small business set asides, i.e., items set aside for procurement from small taxpaying businesses. Estimated sales of these fourteen items is approximately nine million dollars. The Knox County manufacturing facility was attempting to obtain sole supply contracts for Item Nos. 9821, 9822 and 1997, which aggregate over 40% of the total small business set aside of metal office furniture from the current GSA procurement list. In other words, from the current list of set asides of metal office furniture for taxpaying small businesses all over our Country, the Knox County facility was attempting to become the sole supplier of items constituting over 40% of the total.

The action before the Committee on Items 9821 and 9822 has been delayed due to a procedural determination by GSA. However, Jebco anticipates that the action will be pursued further and is deeply concerned over its future.

It would appear that Jebco's greatest competitor is not the large and small businesses it bids against regularly, but rather a small group of tax exempt, government protected manufacturing facilities. These facilities do not compete for business under the JWOD, but rather are "awarded" business at administratively determined prices which by formula exceed the most recent competitive price.

Like all good citizens, Jebco generally supports a policy of helping those less fortunate. However, such policy must be implemented with common sense and reason; with due regard to the costs to taxpayers as well as the costs to those specifically impacted by preferential treatment for others; and with due regard to other legitimate policy concerns, such as encouraging minority employment, encouraging employment opportunities in labor surplus areas, encouraging small businesses, encouraging full and open competition, and encouraging procurement policies under which the government obtains that which it needs at the lowest price. We are concerned that at least in the area of procurement of metal office furniture, the JWOD is not being implemented with the aforementioned concerns in mind.

We understand that the JWOD program has grown from some twelve million dollars in the early 1970's to approximately three hundred million dollars today, and that it is growing at a rate of some twenty five million dollars per year. From our analysis of the matter to date, it would appear that at least in the area of metal office furniture, a substantial portion of this volume is derived from items historically produced by small businesses under competitive procurement procedures. Indeed, it would appear that the impact primarily is on a few small businesses, like Jebco, which provide entry-level employment in the industrial marketplace and are fairly labor intensive. Only a few years ago, Jebco employed some 350 people. It now employs 195. There is no doubt that at least part of this reduction in employment is due to the fact that many items that Jebco used to compete for and produce are now produced solely by tax exempt manufacturing facilities.

Under the JWOD, the Committee has extremely broad discretion in determining which items are to be removed from the normal competitive system and placed on the special list. The basic standard is whether, in the Committee's discretion, a particular item is "suitable" for placement on the special list. In making this "suitability" determination, the Committee's regulations indicate that one factor for consideration is whether the addition of the particular item in question will have a serious adverse impact on the current or most recent contractor for the particular item. However, there is no requirement that the contractor receive actual notice of the proposed action. Further, there is no stated requirement that the cumulative impact of decisions to remove numerous items be considered. Yet it is this cumulative impact which places Jebco's future in jeopardy, and indeed, places in jeopardy other small businesses which manufacture metal office furniture.

Jebco, like other small contract manufacturers, has no permanent government business. It must compete on an ongoing basis with other suppliers, large and small, for government contracts. On any given item at any given time, Jebco may not be the low bidder and may not have the contract. If the Committee made a determination on such item at such time, Jebco apparently would have no standing to even object, although it may have produced the item in the past and would intend to bid on the item in the future. As more and more items are removed from competitive procurement, there obviously is less to bid on. Jebco has already identified a number of items removed from competitive procurement without its knowledge. Now it finds a number of additional items under consideration. Where does the process end?

As you consider the current appropriation for the Committee, we respectfully urge you to keep the following concerns in mind:

1. Why is no actual notice of proposed Committee action given to those directly and adversely impacted by the action?

   Actual notice of the Committee's proposals to remove items from competitive procurement should be given to all known suppliers of the item in question. At least those adversely impacted would then have the opportunity to protest. A one-time publication of a short statement in the Federal Register is the only current requirement. Like most small businesses, Jebco does not have the staff or resources to monitor all Federal Register publications by government agencies that may affect its business. What we found particularly disturbing in the proceeding on Item 9821 was that Jebco was specifically identified months ago by the Committee as the company primarily impacted by the proposal, yet no actual notice by the Committee was even attempted, much less given. Investigation will undoubtedly reflect that in many Committee actions no competing concerns were raised because the impacted parties had no knowledge of the action. The Committee knows who the impacted parties are, and it would only cost pennies to notify them of pending actions and to provide them a copy of their procedural rights.

2. Who represents the interests of taxpayers and of private taxpaying businesses in the Committee's proceedings?

   The Committee should have members representing the interests of the private, taxpaying sector. Given the trends, it would appear that members representing small, taxpaying businesses are also needed. Factors other than "suitability" obviously should be considered in any decision.

3. Who monitors the cumulative impact of the Committee's decisions and how frequently?

> There appears to be no regular review of the cumulative impact of the Committee's decisions. In other words, once an item is placed on the list, it is there permanently, and is no longer factored into the Committee's deliberations on subsequent items. We believe the items already removed from competitive procurement should be reconsidered periodically and regularly with a specific focus on the cumulative impact of their removal on government costs and on full and open competition for government business.

Although these comments are directed towards the pending appropriation for the Committee, we are also concerned over other programs, such as the Federal Pension Industries Program, under which non-taxpaying entities are awarded government contracts to produce items that used to be the subject of full and open competition. We are concerned that no one is monitoring the cumulative impact of these programs on small businesses, on employment patterns, or on costs to the government.

We would appreciate your careful attention to Jebco's views and request that you make these comments a part of the official record of the proceedings on this matter.

Thank you.

Respectfully submitted,

Troutman, Sanders, Lockerman Ashmore

By: Stanley H. Hackett
Stanley H. Hackett
Attorneys for Jebco, Inc.

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

STATEMENT OF DAVID E. NETHING, MEMBER

ACCOMPANIED BY:

JOHN SHANNON, EXECUTIVE DIRECTOR
FRANKLIN A. STEINKO, JR., BUDGET AND MANAGEMENT OFFICER

PREPARED STATEMENT

Senator Abdnor. The subcommittee will be back in order. We have before us Mr. Dave Nething from the Advisory Commission on Intergovernmental Relations. You can introduce your colleagues. Again I will tell you, Dave, we are more than happy to have the entire statement placed in the record and just have you summarize.

[The statement follows:]

STATEMENT OF DAVID E. NETHING

Thank you, Mr. Chairman. My name is David Nething. It is a pleasure to be here this morning to discuss the work of the Advisory Commission on Intergovernmental Relations (ACIR). I am a state senator from North Dakota, and one of three state legislative members of ACIR. Chairman Robert B. Hawkins, Jr., sends his regrets for not being able to be here today. He has designated me to present the Commission's testimony. I am grateful for this opportunity.

Serving Congress

Last year when Chairman Hawkins came before this Subcommittee, he presented a report just off the press entitled Cigarette Tax Evasion: A Second Look. That report had been specifically requested by this Subcommittee in its report the previous year--a request that was in the tradition of Congress relying upon ACIR to perform special studies.

Topics studied at the direct request of Congress have addressed many aspects of the federal aid system, including countercyclical aid, block grants, and General Revenue Sharing. Other studies have dealt with more general topics such as the federal, state, and local roles in the federal system, and citizen participation. Altogether, eight specific Congressional requests have produced 25 ACIR reports.

The most recent products resulting from a Congressional request are four working papers prepared for the Treasury Department in response to the Local Government Fiscal Assistance Amendments of 1983. These papers dealt with turnbacks of federal revenues and responsibilities, the desirability and feasibility of federal fiscal equalization, welfare reform, and federal income tax deductibility of state and local taxes.

Additional topics are continually added to the Commission's agenda. For example, at the request of the Senate Intergovernmental Relations Subcommittee, the Commission authorized a study, at its last meeting, concerning the effects of the depressed farm economy on state and local services and tax revenues in rural areas. This research is critical to understanding the long-term impacts of the farm crisis. No other agency is studying this problem--an issue that the ACIR is uniquely qualified to examine.

Periodic Congressional Review

At our request, Congress evaluates the work of the Commission every five years, making recommendations that have improved our operations. As a result of Congressional suggestions, for example, ACIR holds some of its meetings outside of Washington, DC; has adopted a formal set of bylaws and operating procedures; and has established a program of state contributions for financial support of the Commission's program. The most recent Congressional review occurred in 1984 on the occasion of the Commission's 25th anniversary.

Serving the Executive Branch and States

Over the years, the Commission has published well over 300 reports. One-third of these have been policy reports containing several hundred recommendations to all three levels of government. Thirty-one of these reports were initiated or supported by individual federal agencies, including the White House and a number of executive agencies.

Many of the recommendations from the Commission's reports have been embodied in draft federal and state legislation. At the national level, Congress has enacted Commission-supported General Revenue Sharing, intergovernmental consultation procedures, block grants, and the national urban policy process. ACIR was also instrumental in building support for enactment of the Congressional fiscal note process for evaluating adverse financial impacts of proposed legislation on states and localities. At the state level, Commission recommendations have yielded 120 pieces of suggested state legislation.

ACIR publications have provided much of the background material used by universities for the training of persons entering public service at all levels of government. When Congress created ACIR over 26 years ago, there was very little scholarly literature on the subjects of federalism and intergovernmental relations. ACIR's work not only has directly added to such resources, but also has stimulated similar work by others. We also maintain a large data base on federal, state and local government fiscal data.

Growing Tensions in the Federal System

Mr. Chairman, as our Chairman, Bob Hawkins, noted last year, the relations between our federal, state and local governments are now undergoing a greater change than at any time since the Great Depression and the New Deal. Constitutionally safeguarded state sovereignty was dealt a stunning blow by the Supreme Court's *Garcia* decision. Continued deductibility of state and local taxes hangs in the balance as tax reform is debated in Washington. The same is true for the continued tax exempt status of many forms of state and local bonds. In addition, federal aid to state and local governments, which has been declining in real terms since 1978, appears destined to retreat still further. These great changes--actual and proposed--are now creating severe tensions for our federal system.

ACIR has been among the leaders in calling for relief from the Garcia decision. It was gratifying to help Congress respond to this critical need with remedial legislation. There still remain, however, many critical issues raised by Garcia that may eventually require Constitutional remedy. The Commission is continuing to work in this field.

In addition, ACIR's work on local anti-trust liability has helped create the climate in which the Supreme Court itself recently eased the antitrust limits on many local regulatory activities.

ACIR's Federalism Forum: Welfare, Turnbacks, and Federal Tax Reform

During this period of change, our intergovernmental system needs the forum provided by ACIR where federal, state, and local representatives can meet as equals to seek to reconcile conflicting interests. Our nation has no other such forum--no other mechanism that forces continuous dialogue among the representatives of all three levels of government.

Twenty years ago, our nation enjoyed a high degree of consensus about how the functions of government should be divided among the federal, state, and local levels; a strong centralizing growth in federal aid supporting national priorities was widely accepted. Today, that consensus is missing. The nation is rethinking the role of the national government. There is a growing focus on decentralizing the system, and the issues of welfare reform, tax reform, and overall federal-aid reform are central to this reevaluation. ACIR is uniquely positioned as the honest broker to assist Congress and others as they grapple with these complex issues:

- On welfare reform, the Commission is holding a series of hearings and conducting research designed to bring a variety of state experiences with workfare and other innovations to bear on the redesign of national welfare programs.
- On federal income tax reform, the Commission is providing a unique function that is available from no other source: a comparative analysis (state-by-state) of effects of the Treasury II Proposal, the House-approved plan, and other proposals, upon federal income taxpayers and on state finances.
- On streamlining federal aid to states and localities, the Commission has set forth criteria for judging which federal aid programs could be turned back to states and localities together with the requisite revenue sources, and has examined several specific proposals designed to make the operation of the nation's intergovernmental system more accountable and more efficient. The Commission's current report on this topic--to be published this month--urges Congress and others to examine a series of proposed turnback packages.

A Leaner Organization

Over the past several years, along with many other domestic agencies, the Commission has been faced with rising costs along with a decline in revenue (in real terms). We have made significant changes in our operations to adjust to this situation. Our staff is now approximately 40% smaller than it was during our peak employment period of the later 1970s; we have substituted word processors and personal computers for clerical and support staff so that our professional staff is more self-sufficient; we have substantially reduced our office space; we have closed our print shop; and we have gone to a streamlined publications process which eliminates the expenses of typesetting and multiple proofreading. We have tried to maintain the research quality of our reports.

These belt-tightening actions have helped us to maintain our research and publishing activities at approximately the level of the past. However, we have cut back substantially on the number of copies of each report printed. We have also sharply reduced the number of "free" copies.

In addition, we have developed new and stronger relationships with a network of state ACIR counterpart organizations in 24 states where such bodies exist. We are exploring ways for cooperating with the state ACIRs in research in order to eliminate duplication and strengthen our mutual efforts.

Outside Funding

Mr. Chairman, we recognize the Congress' wisdom in suggesting that we look toward outside funding to a greater extent in the future. Steps are being taken right now to strengthen our procedures for soliciting voluntary contributions from the states--33 states made contributions during the 1985 fiscal year. In addition, we have begun rationing our reports through a pricing policy, even though we are not allowed, currently, to retain the earnings from these sales. With Office of Management and Budget approval, we are submitting suggested appropriations language that would give us the authority we need to put our publishing activity on the road toward self sufficiency.

Finally, Mr. Chairman, we are seeking grants from outside sources to support two of our current research efforts--a study of the role of federal courts in the federal system, and a reexamination of federalism principles in the United States Constitution--our contribution to celebrating the Constitutional Bicentennial years beginning in 1987.

For the judicial project, we have been in contact with over 30 foundations as well as the federal Departments of Justice, Education, and Health and Human Services. I have been involved in this effort personally, as have Attorney General Meese, Governor Thornburgh of Pennsylvania, and our own Chairman Hawkins. A similar effort will soon be made to raise funds for the Bicentennial project.

ACIR Budget Initiatives

The full Commission is becoming increasingly involved in budgetary matters, and Chairman Hawkins has appointed a budget committee, chaired by Kansas State Senator Ross Doyen, to monitor our expenditure needs and to pursue all possible options for increasing outside funding of our organization. Together with our continued belt-tightening efforts, we are confident that with Congressional approval of our request we can maintain a program adequate to the needs of the next several critical years for our federal system.

As the national government continues to rely increasingly upon state and local governments to carry out the nation's domestic agenda, we see a real need for increased Commission focus on improving state-local relationships. There is also a need to maintain a keen national government sensitivity to the effects of its actions on the states and their localities.

I urge you to approve the requested appropriation for our Commission--an action that would enable us to continue assisting

Congress and policymakers in the other branches and levels of government during this period when the federal system is undergoing extraordinary stress.

Thank you for this opportunity to describe our mission and our commitment to you. I will be happy to answer any questions you might have.

INTRODUCTION OF ASSOCIATES

Mr. Nething. Thank you, Mr. Chairman. For the record, my name is Dave Nething. I'm the senate majority leader in North Dakota and I am a member of the Advisory Commission on Intergovernmental Relations, one of the three State legislative members on the Commission.

With me today is Mr. John Shannon, who is the Executive Director of the Advisory Commission; and, Mr. Franklin Steinko, who is our budget and management officer.

CHANGING INTERGOVERNMENTAL RELATIONS

Mr. Chairman, we have our statement ready for submittal. There are a few things I would like to visit with you about as far as the Commission is concerned. I know you are as aware as all of us that the Federal system is undergoing dramatic change in how Congress and how we, at the State and local levels, respond. It is going to have a profound impact on how Americans are governed, not only throughout the rest of this century but long beyond.

That is why it is vitally important that we have the finest in research and recommendations on courses of action that we can select from in intergovernmental relations. That is where the role of the Advisory Commission comes in. Mr. Chairman, I think you are aware that ACIR is like all other congressionally sponsored commissions. We do submit an annual report to the President, the Speaker, and the President of the Senate.

Traditionally our report has always opened up with a statement to show how our research and activities are responding to changing circumtances as it relates to the status of American federalism.

I would just like to summarize some of those items over the past 10 years on which ACIR has responded and indicate how we can continue to respond to changing conditions in Government.

Back in 1975 the big shock wave that hit the American Federal system was the New York City financial crisis. State and local officials, bankers, scholars, the public, and the press became aware of the fiscal distress of State and local governments. As a result of that event, a study that we had prepared in 1973 called "City Financial Emergencies" came into great demand and we released a report entitled "Trends in Fiscal Federalism: 1954–74."

We also took note of the continued proliferation of categorical grant-in-aid programs, by publishing a 1975 report titled "Federalism in 1974: the Tension of Interdependence." And at that time in 1975 we were in the process of preparing a series of 14 reports under the general title of "The Intergovernmental Grant System: Policies, Process, and Alternatives" which were published over the next 3 years. In addition, the staff began to identify the factors leading to the growth in the public sector.

Just 3 years later our year-end report for 1978 noted that the forces leading to the growth in the public sector had received a setback; the shock wave that hit the Federal system at that time was California's proposition 13, and it engendered a nationwide tax revolt. The Commission published a report on interstate tax competition and we continued our annual polling on the changing public attitudes on Government and taxes.

Taxpayer pressure led governments at all three levels to consider many courses of action that had scant likelihood of adoption earlier, such as the indexation of income taxes, a step that had been formally recommended by ACIR. In addition, the report noted that the Federal grant-in-aid system had received considerable attention as the Carter administration and others sought to make the system more efficient rather than just making it larger. This trend of shrinking grant-in-aid dollars would, of course, continue and as we have seen accelerate and would be of paramount importance in ACIR's deliberations. As a matter of fact, in 1983 we coined the term "de facto new federalism."

Then moving along to 1981 our annual report stated "At the heart of the changes underway is no less than the transition from a federally dominated form of federalism to what hopefully will be a more balanced intergovernmental system." And our research and recommendations during the eighties reflected this shift. We published two series, one on the Federal role in the Federal system and the other on the State and local roles in the Federal system. Significantly, throughout the late 1970's and early 1980's we were reporting a little noticed phenomenon, the growing sophistication and competence of State and local governments.

In 1981 we said the question of State capacity was raised again and again throughout the year and more often than not ACIR's research was used to bolster the case for the strong State role. This trend continued to be a central theme in many of our reports.

FEDERALISM TODAY

And then in 1985 the public recognition of this transition was complete. In our annual report, submitted to Congress this past January, we said:

> Future students of American federalism may come to regard 1985 as the year of the phoenix for States. After being the dominant force in governing during the republic's first 150 years, then disparaged during the last half century, the States today as well as their subdivisions are receiving high praise from many quarters and are reclaiming some of their traditional functions from the National Government.

This transition is not occurring without considerable intergovernmental tension. As it has done throughout its existence, the Commission's current research and analysis is endeavoring to monitor this growing decentralization process and recommending mechanisms for smoothing the transition into this new era.

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS IS RESPONDING

Mr. Chairman, my written testimony details our current research agenda, but I would like to highlight about six things that we have ongoing that I think are significant. No. 1 is the *Garcia* decision. As a result of last year's Supreme Court decision in *Garcia* v. *San Antonio*

Metropolitan Transit Authority, we published a comprehensive information report titled "Reflections on Garcia and its Implications for Federalism."

Another subject is turn backs. Last year the Commission recommended the return of program authority to States and localities along with tax sources to finance them as one mechanism for sorting out responsibilities in the Federal system. A full report on that subject is forthcoming.

Another area is welfare reform. ACIR has had a longstanding interest in the intergovernmental aspects of welfare, and we are now in the process of holding a series of hearings and undertaking a comprehensive study of welfare reform.

Another area is tax reform. We have prepared and are continuing to update evaluations of the implications of the proposals regarding deductibility of State and local taxes in the tax reform debate. In fact, we have just delivered some preliminary figures to Congress comparing the impact of the Reagan administration's plan versus the House plan.

Another area is judicial federalism. We are undertaking a major study of the impact of court decisions on federalism. This is a topic of much current debate and we just published a framework paper for the study.

And another study that we have underway is the effect of the farm crisis on State fiscal policy.

Mr. Chairman, in my role as the president of the National Conference of State Legislatures, I have visited 11 States since the middle of January. South Dakota, by the way, was the first State legislature I visited in mid-January. On my way home from this trip to Washington, I will be visiting the Wisconsin Legislature. It is interesting, as I visit these States across the country—including the southern States and the western States—I sense the feeling in the State legislatures right now is that deficit control is really the No. 1 issue for them. The No. 2 issue—or the No. 1 local issue—is dealing with liability insurance.

I believe that State legislatures are really doing their share in adopting federalism changes, and we need sound analytical research because that is what legislators are basing their decisions on. I hope that I have enumerated the enormous changes that have occurred in the Federal system over the short span of 10 years, and I hope that I have demonstrated how the Commission's work continues to be an invaluable contribution to public debate and sound policymaking.

I would be happy to answer questions.

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS' IMPACT

Senator ABDNOR. Thank you, Dave. Do your reports get a pretty warm reception by the States and the State legislatures throughout the country? Are they pretty well received once you write them up and send them out. Do they pretty well represent the thinking?

Mr. NETHING. Pretty much. I plan on visiting 25 States in my term as president of NCSL to get a feel out there of what the big issues are. As I travel, I am really amazed. I thought there would be a whole lot of interest in tax reform. I thought there might be a lot of big, major interests elsewhere. But as we sit around, as legislative leaders and we talk about the various things, and pick out the items of concern that they are struggling with, those are the ones, the really meaty ones. They know that the Federal deficit has got to be reduced because of the impact it is having in marketing their agricultural products and things of that nature. I think it is pretty consistent.

GRAMM-RUDMAN-HOLLINGS IMPACT

Senator ABDNOR. You have the same problem all the other agencies do. You are confronted with an $88,000 cut. How did you generally absorb that?

Mr. SHANNON. Mr. Chairman, we anticipated a cutback and we absorbed most of it by not filling vacant positions. That was the primary action. There were some secondary actions that we also took for belt tightening. We have cut back on our library operations. We have cut back some on our printing obligations. But primarily our decision not to fill vacancies when they occurred was the way we have handled it.

I might, as a footnote, indicate that our staff now is 26 professional and clerical. It is about the same size as it was back in the mid-sixties, and it is 36 percent less than it was in the late seventies.

Senator ABDNOR. What was that?

Mr. SHANNON. About 36 percent less. Back in about 1978 we were up to 50 people. So we have absorbed a lot of the cutbacks on the personnel front.

Senator ABDNOR. When you get back to your office, would you send us the details on that.

Mr. SHANNON. We will.

INTERAGENCY RESEARCH CONTRACTS

Senator ABDNOR. The Commission has reimbursable expenses totaling $14,000. That is down from $251,000 in 1985. To whom is this reimbursement and why the major reduction? It is fine, but we were just wondering.

Mr. SHANNON. I will ask our long time budget officer to go into that.

Mr. STEINKO. There were two reasons for the decline, the first one being that the Office of Management and Budget directs that all interagency contracts be handled on a reimbursable basis. Last year there was a large Treasury contract which was included representing $200,000 of the amount. The second point is the decision made by OMB that the reimbursements from the sales of publications or data resources no longer could be utilized by the agency and must be deposited directly into the Treasury. This has caused a setback that we did not anticipate nor did we desire. And we are seeking to rectify it this year with OMB and get approval for a change.

Senator ABDNOR. You are getting that worked out, are you?

Mr. STEINKO. Yes, sir; they had suggested language subject to limitation. Currently there are no interagency contracts in force except for our management contract with the Truman Scholarship Foundation. We are also hoping to sign a management contract with the National Council on Public Works Improvement within the next couple of weeks. Those will be reflected in there.

STATE CONTRIBUTIONS

Senator ABDNOR. You were talking about the goal for State contributions. In 1987 I believe it is $120,000. How does this compare with the 1986 goal and your 1985 goal and your actual receipts? Was it what you anticipated?

Mr. SHANNON. Mr. Chairman, in this current year, 1986, 33 States made voluntary contributions to ACIR, and it totaled somewhat under $80,000. We plan in the next year to, shall I say, rattle the tin cup much more vigorously, and use our Commission members who are scattered throughout the States to help us in this department. But I must say in all realism, we are going to encounter some real problems.

Several of the State budget officers from the farm States have already written to us indicating that they may not be able to make contributions this year or next year.

Senator ABDNOR. What was the average?

Mr. SHANNON. The average contribution was running a little over $2,000, but we plan on increasing the contribution requests, perhaps double them.

Senator ABDNOR. That does not seem out of line, as much as they rely on you people.

Mr. NETHING. One of the things that happens, too, Mr. Chairman, is that I believe there are 24 States that have their own advisory commissions. They function a little different than we do. Those commissions do not go into the research like we do here. They go more into the relationship with the cities and counties and the development of internal State programs. And because they have that, there's somewhat of a reluctance from some of the legislators that do not fully understand the role of the Federal ACIR. They claim they are already financing their own ACIR and that Washington should go and do likewise.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Good luck. I know you are well received by the States. I do have a number of other questions we will submit to you. Thank you very much.

Mr. NETHING. Thank you. It was good to see you again.

Senator ABDNOR. Nice seeing you.

[The following questions were not asked at the hearing but were submitted to the Commission for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Senator Abdnor. Since FY 1985, there has been a considerable change in the identification codes devoted to 2.3--Communications, Utilities, and Miscellaneous Charges and 25.0--Other Services. Is there any correlation?

Mr. Shannon. The Office of Management and Budget directed us to shift our maintenance costs for equipment and the like from code 23.3 to code 25.0. That has been done, so the increase in code 23.3 expenditures from fiscal years 1986 to 1987 is very modest; most of those increases represent higher postal charges. The big drop in code 25.0 expenditures between fiscal years 1985 and 1986 represents reduced contractor products. There is no correlation between these shifts.

Senator Abdnor. Could you give us a progress report on your 1986 projects? What do you contemplate for FY 1987?

Mr. Shannon. So far in fiscal year 1986, we have published four major policy reports on the subjects of (1) state aid to distressed communities, (2) the use of intergovernmental service agreements for delivering local public services, (3) devolving federal program responsibilties and revenue sources to state and local governments, and (4) the taxation of out-of-state mail order sales by state and local governments. In addition, we have published two issues of our quarterly magazine, Intergovernmental Perspective, plus results from our 14th annual public opinion poll on attitudes toward governments and taxes, and five major information reports concerning (1) the condition of American federalism, (2) significant features of fiscal federalism, (3) reflections on the Supreme Court's Garcia decision, (4) the tax capacity of the nation's 50 states, and (5) a framework for studying the role of federal courts in our federal system.

For the remainder of fiscal year 1986, we contemplate publishing additional reports on local revenue diversification, state-by-state analyses of proposals to reform the federal individual income tax, and the role of political parties in strengthening our federal system. In addition, we expect to produce two more issues of our magazine.

For fiscal year 1987, we contemplate issuing major new reports on (1) welfare reform, (2) lessons for the federal government from experience with fiscal discipline mechanisms at the state level, (3) federal preemption of state and local laws and authority, (4) alternative approaches to providing local public services, (5) rethinking local self-government, and (6) an analysis of intergovernmental aid formulas. Of course, we also expect to continue publishing our quarterly magazine and updating our annual reports on (1) significant features of fiscal federalism, (2) the fiscal capacity of the states, and (3) public attitudes toward government and taxes.

Senator Abdnor. Last year we asked you to absorb the proposed pay increase. Does your 1987 budget request restore the funding that would have been there were you not forced to make the absorption?

Mr. Shannon. There was no pay increase to be absorbed last year. Our increased appropriation request for fiscal year 1987, approved by the President, was based completely upon increased charges from other federal agencies, principally the postal service.

Senator Abdnor. Your request for FY 1987 does not include adjustment for the FY 1986 Gramm-Rudman-Hollings sequestration that has already taken effect. If that total was applied to your 1987 request, what would happen?

Mr. Shannon. It would reduce our 1987 request by $88,000.

Senator Abdnor. Would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

Mr. Shannon. We could adjust to an appropriation of $2,002,000.

Senator Abdnor. Have you reached the 135 square foot goal? If not, why and what is your target date?

Mr. Shannon. We have not yet reached that goal because our building, as currently laid out, is not suited to it. GSA has provided a waiver while it studies the options for reaching that goal. We have reduced the space we occupy each of the last three years, dropping from 12,200 square feet to 10,000 square feet and reducing the space per employee from 183 square feet to 151. It appears, now, that the cost of further reductions may outweigh the potential savings.

QUESTIONS SUBMITTED BY SENATOR DENNIS DECONCINI

Senator DeConcini. I notice that the Commission spends 29% of its direct appropriation budget on general administration with the balance spent on intergovernmental research--your principal mission. That seems like an inordinately high overhead-to-research ratio. Can you explain why the Commission needs to spend 29% of its budget for administration?

Mr. Shannon. The simple answer is that we actually allocate about 13% to that task. Being such a small organization, we have not previously spent much time developing cost accounting measures. Therefore, the breakdowns in our budget were derived very roughly from an organization chart that does not accurately reflect the multiple assignments of many people in the organization. As our staff has shrunk from 50 person-year equivalents in the late 1970s to 32 today, most of our remaining administrative personnel have been assigned part-time to non-administrative tasks.

Following our Chairman's December 1985 appointment of a budget committee consisting of four commission members, the staff prepared a detailed staff allocation matrix showing the assignment of all personnel to the 50 tasks we are undertaking currently. This matrix shows quite clearly that we have two major missions: (1) developing research reports and other similiar products, and (2) providing services to outside groups for purposes of putting our products to work. Approximately 71% of our total effort is directly allocated to identifiable projects under these two functions. Another 10% is allocated to overhead items directly supporting these primary functions (typing, library, professional development and training, and program development). Approximately 6% of our budget is devoted to our policymaking function (supporting our 26 Commission members, their regular quarterly meetings, and other events such as public hearings). The remaining 13% of our effort is devoted to general administration (budget and finance, office management, data and records management, personnel management, fund raising, and property management). We have a very flexible staff, capable of taking on assignments across organizational lines and getting the job done under changing circumstances.

Senator DiConcini. You estimate that you will receive an additional $170,000 next year in contributions from state and local governments, nonprofit organizations, and private foundations to the Advisory Commission Trust Fund. In light of the rigid budget constraints we are operating under this year, why not cut your appropriation back by $170,000 and force you to use that money to fund some of your operation next year? That might force you to rethink your administrative costs and make some tough choices.

Mr. Shannon. Senator, let me emphasize that such outside funds are by no means assured. Nevertheless, we have established over the years a relevantly reliable source of contributions from state governments running in the $70,000 to $80,000 range annually. We also have a history of seeking grants from other organizations on a project-by-project basis. We hope to receive some new grants in the future, although we have none at present. These funds, of course, when we receive them, are used to fund our operations.

Two of our major current research projects are unfunded and we are pursuing grants for them at the present time. These two projects deal with (1) the role of federal courts in altering the responsibilities of, and financial demands upon, state and local governments, and (2) a reevaluation of the federalism provisions in the United States Constitution as our contribution to celebrating the Bicentennial of the Constitution. Needless to say, these grants are no more certain than the appropriation we are seeking from Congress.

If our appropriation were cut by $170,000 in anticipation of these outside funds becoming available, the cut would be a real one. ACIR's resources have been squeezed now for several consecutive years. We were forced to RIF three of our staff members in fiscal year 1982 and have since reduced our staff by a additional seven persons through attrition. We have also taken a number of additional belt-tightening steps, including automating our typing and publishing processes, reducing our space, and cutting back on our library and publications distribution fuctions. Of course, it is always possible to make further cuts in our activities, but our current reduced program now is at a level barely sufficient to maintain a challenging agenda for the Commission at its regular quarterly meetings. The attached memorandum outlines the five major factors that our Commission is weighing concerning our future budgets.

I believe that ACIR has less administrative overhead and higher productivity than almost any other federal agency. Our work has been of special value to the Congress (providing 25 reports to it at its own request), to the White House, to the *nation's 50 states and to their more then 80,000 localities*. Our output has exceeded 300 public reports over the past 26 years and we hope to continue providing this service to the nation.

As noted in our testimony, we are currently working on vital issues in our federal system arising from the federal government's cutbacks in its domestic responsibilities and tax reforms directly affecting state and local revenue systems.

I invite you to take a close look at our operation. I have full confidence that you will find us worthy of the appropriation that the President has requested for us.

March 27, 1986

MEMORANDUM

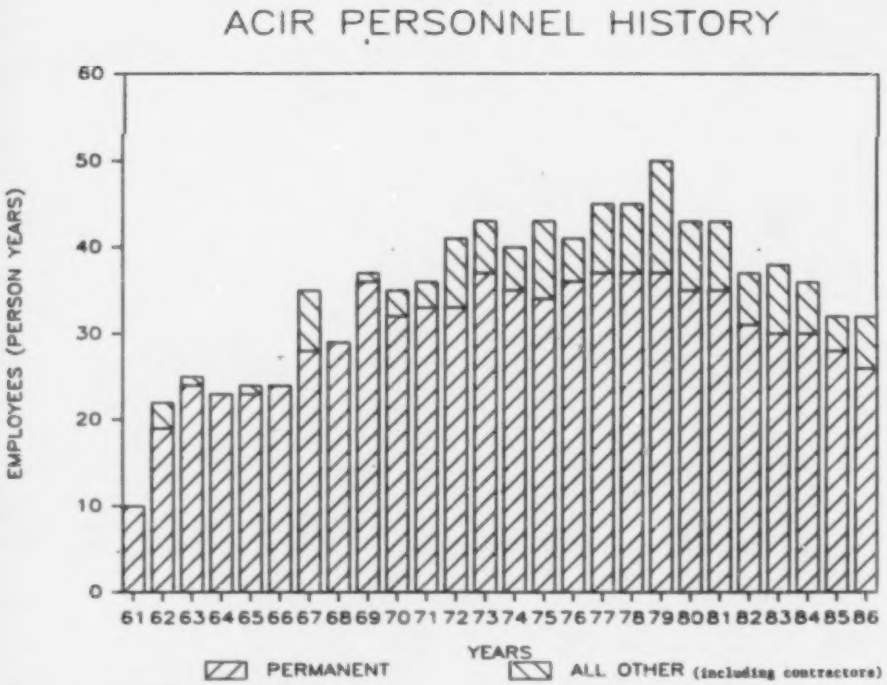
TO : Members of the Advisory Commission on Intergovernmental Relations

FROM : John Shannon, Executive Director

SUBJECT: The ACIR Budget Situation--Background Information

In formulating ACIR budget policy, the Commission may find the following five facts of interest.

First, there has been a substantial decline in the number of ACIR staff personnel since the late 70s. Due to reductions in both Congressional appropriations and outside funding, the ACIR personnel count has dropped from 50 (full-time equivalent) in 1979 to 32 for the current year. Permanent staff during this period dropped from 38 to 26. This 36% cutback in personnel is dramatically illustrated in the chart set forth below.



Second, in anticipation of continuing appropriation cuts, several belt-tightening actions were taken during the last year.

- By not filling several vacancies, adequate funds were accumulated to absorb the 4.3% Gramm-Rudman-Hollings cuts that became effective March 1, 1986.

- Several existing staff members in Administration and Communications and Publications were assigned short-term research tasks to respond rapidly to Commission-initiated projects without pulling resources away from the regular research programs approved earlier by the Commission. The first project undertaken by this group is the farm recession study requested by Senator Durenberger at the December 1985 Commission meeting.

- To provide greater flexibility within our reduced budget, we have placed increased reliance on contract personnel.

- The full staff--clerical and professional--is now automated with either word processors or computers, making professionals substantially more self-sufficient, minimizing the amount of time devoted to typing, and greatly simplifying and speeding up the publication of ACIR reports.

- While ACIR has continued to publish new reports at a good clip 1/, the number of copies printed of recent ACIR reports has been sharply reduced and most copies are now offered for sale. The number of copies distributed free has been drastically reduced.

- The library operations were streamlined by merging the duties of the librarian with those of the Public Information Officer. In lieu of new book purchases and paid subscriptions, we have contracted to use the facilities and resources at Georgetown University as a cost saving measure. Additionally, we have converted our library space into our conference room by reducing the size of the collection and placing it around the perimeter.

- The amount of space occupied by the Commission's offices was cut from 12,200 square feet to 10,000 square feet, and consolidated in a more compact arrangement on a single floor. Our warehouse space was reduced from 4,800 square feet to 4,000 square feet, and our inventory of old reports was also greatly reduced.

Third, assuming that the deficit reduction objective of the Gramm-Rudman-Hollings plan is realized, the ACIR can expect an appropriation cutback of approximately 25% over the FY 86-FY 88 period. This anticipated cutback is based on the following assumptions--4.3% (actual) in FY 86, and an approximate 10% reduction in both FY 87 and 88. In dollar terms, this would mean that our present FY 86 appropriation of $2 million would be trimmed to approximately $1.5 million by fiscal year 1988.

Fourth, ACIR should be able to absorb these Gramm-Rudman cutbacks over a three year period if the following actions are taken:

- a rigorous effort made to solicit voluntary contributions from the state governments--an effort that would call for increasing the size and number of the contributions and for intensifying Commission member involvement in the fund raising; 2/

- congressional authorization for ACIR to keep the proceeds from the sale of its publications, other products, and services;

- a stepped up effort to obtain research grants from federal government agencies and private organizations.

Fifth, if Congress should adopt the suggestion that calls on the states to finance half of the cost of ACIR, such action would call for a complete rethinking of the structure and purposes of the Commission and a potential revision of the legislation that created the Advisory Commission on Intergovernmental Relations.

1/ See attachment for a listing of ACIR publications issued between March 1985 thru April 1986.

2/ In 1985, 33 states contributed approximately $75,500.

PUBLICATIONS ISSUED BY ACIR
MARCH 1985 THRU APRIL 1986

Intergovernmental Perspectives

"1984: Not a Good Year for 'Big Brother'," Winter 1985, Vol. 11, No. 1.

"Garcia vs. San Antonio: Federalism Under Fire?" Spring/Summer 1985, Vol. 11, No. 2/3.

"To Deduct or Not to Deduct? That is the Question," Fall 1985, Vol. 11, No. 4.

"Welfare Reform -- The Search for Consensus," Winter/Spring 1986, Vol. 12, No. 1/2.

Policy Reports

A-99 "Bankruptcies, Defaults, and Other Local Governments Financial Emergencies," March 1985, $3.00.

A-100 "Cigarette Tax Evasion: A Second Look," March 1985, $5.00.

A-101 "The States and Distressed Communities: Final Report, December 1985, $5.00.

A-103 "Intergovernmental Service Agreements for Delivering Local Public Services: Update 1983," October 1985, $5.00.

A-104 "Devolving Federal Program Responsibilities and Revenue Sources to State and Local Governments," March 1986, $3.00.

A-105 "State and Local Taxation of Out-of-State Mail Order Sales," April 1986, $5.00.

Information Reports

M-141 "Significant Features of Fiscal Federalism: 1984," April 1985, $7.00.

M-142 "1982 Tax Capacity of the Fifty States," May 1985, $7.00.

M-143 "Emerging Issues in American Federalism. Papers prepared for ACIR's 25th Anniversary," August 1985, $5.00.

S-14 "Changing Public Attitudes on Governments and Taxes," October 1985, $3.00.

M-144 "The Condition of American Federalism: Hearings Held in ACIR's 25th Anniversary Year," February 1986, $5.00.

M-146 "Significant Features of Fiscal Federalism: 1985-86," February 1986, $10.00.

M-147 "Reflections on Garcia and Its Implications for Federalism," February 1986, $3.00.

M-148 "1983 Tax Capacity of the States," March 1986, $10.00.

M-149 "A Framework for Studying the Controversy Concerning the Federal Courts and Federalism," April 1986, $3.00.

Staff Working Papers (March 1985 through April 1986)

"Designing a More Efficient and Effective Means Tested Welfare System: Welfare Reform in an Intergovernmental context," April 1985.

"Federalism in America's Complete Consitution," December 1985.

"Federal Income Tax Deductibility of State and Local Taxes," March 1986. (To be published by the Office of State and Local Finance, U.S. Treasury, Studies of Federal-State-Local Fiscal Relations, Technical Papers.)

"The Farm Crisis--Its Impact on State and Local Governments," April 1986. (To be incorporated into a report to be issued by the Senate Subcommittee on Intergovernmental Relations.)

U.S. MERIT SYSTEMS PROTECTION BOARD

STATEMENT OF MARIA JOHNSON, ACTING CHAIRMAN

ACCOMPANIED BY:
DENNIS DEVANEY, MEMBER
EVANGELINE SWIFT, MANAGING DIRECTOR
PAUL TRAYERS, LEGISLATIVE COUNSEL
DOUGLAS WADE, BUDGET OFFICER

INTRODUCTION OF ASSOCIATES

Senator ABDNOR. The next witness will be Maria Johnson, Acting Chairman of the Merit Systems Protection Board. We welcome you to the committee. Introduce your colleagues here when you get them seated. Go right ahead. I will be right back.

Mr. PARKINSON. We will wait a couple of minutes. He will be back shortly.

[A brief recess was taken.]

Senator ABDNOR. Go right ahead.

Ms. JOHNSON. Good afternoon. I am Maria Johnson, Acting Chairman of the Merit Systems Protection Board. First, I would like to present board member Dennis Devaney, our Managing Director, Evangeline Swift, our Legislative Counsel, Paul Trayers, and Doug Wade, our budget officer. I would like to keep my comments brief and submit a formal statement for the record.

PREPARED STATEMENT

Senator ABDNOR. We will place your entire statement in the record.

[The statement follows:]

STATEMENT OF MARIA JOHNSON

I appreciate the opportunity to appear before you today as the Acting Chairman of the U.S. Merit Systems Protection Board. Before commenting on the Board's Fiscal Year 1987 appropriation request, I wish to acknowledge the leadership and integrity of the Board's former chairman, Herbert E. Ellingwood, whose term of office recently ended. His four-year tenure encompassed the development of major civil service law and significant improvements in the management of Board operations. As a result of his stewardship, the Board takes pride in a current case load and an effective, efficient case processing system. During my tenure as Acting Chairman, I pledge to continue his commitment to excellence as the Board faces new challenges in the future.

I welcome the opportunity to meet with the subcommittee to discuss the Merit Systems Protection Board's appropriation request of Fiscal Year 1987.

Our request will provide the Board the necessary resources to remain current in case processing at both the regional and headquarters levels. This request does not take into account the unpredictable impact of Federal deficit reduction measures which may affect our FY '87 operations. However, I would like to point out that major government-wide reductions during FY '87 will likely result in a significant increase in furloughs and reductions in force throughout the government. Since these actions are appealable to the Board, our case load is subject to an immediate, substantial increase. Timeliness of MSPB adjudication is particularly important to federal agencies because of the adverse budgetary and managerial impact and attorneys fees that delay in MSPB adjudication would cause. I do wish to stress however that our request today is essential to ensure the timely adjudications of our current caseload.

As you will recall, in 1982 the Board experienced a 23% decrease in appropriations just prior to absorbing a 138% increase in appeals caused by the air traffic controller's strike of 1981. Even with the supplemental appropriations assistance you generously provided to the Board at that time, it took the Board 2 1/2 years to eliminate the huge backlog that resulted. I am sure you will agree that sound public policy and prudent fiscal discipline require that the Board receive the resources necessary to avoid a budget-driven backlog.

I shall be happy to inform the subcommittee when appropriate as to the projected increase in MSPB appeals if government-wide reductions take effect.

1985 Highlights

Through reliance on an ongoing strategic planning effort in FY 1985, the Board continued to improve the overall management of its operations. Among these measures was the geographic realignment of six of its eleven regional offices to better balance case load and staff resources. The Board also continued to implement an integrated computer network system. This has contributed to increased efficiency in both the drafting of decisions and the performance of administrative tasks throughout the Board. As a result of these initiatives, the average time to process an appeal in the regional offices was reduced from 113 days in 1984 to 80 days in 1985.

As a reflection of the Board's commitment to excellence, the Board established an in-house faculty to better train its attorneys in significant and complex areas of the law. The Board also sponsored a writing skills seminar to improve the clarity and precision of its written products. These programs further the Board's tradition of developing and maintaining the highest level of legal skills and employee performance.

The Board also conducted an intensive and comprehensive audit/evaluation review of each regional office under the auspices of the Assistant Managing Director for Regional Operations. The evaluation included quality review of decisions and examination of common regional practices, financial and property management, and personnel practices.

These efforts, together with a current case load, support our goal of effective stewardship of the merit systems principles. The leadership of my predecessor and friend, Chairman Herbert Ellingwood, established a management framework which we believe is a model for other adjudicatory agencies and courts throughout the Federal system.

Highlights of '87 Submission

Our fiscal '87 request is for 364 Full Time Equivalent positions and $20,251,000. This request, which is $251,000 more than appropriated for 1986, allows for inflationary increases in support costs.

The request provides sufficient staff to adjudicate 10,500 cases in a timely and fair fashion during FY 1987. The request encompasses productivity improvements instituted during the past several years.

I shall be happy to answer your questions.

LEADERSHIP OF CHAIRMAN ELLINGWOOD

Ms. JOHNSON. Thank you. I would like also for the record to acknowledge the fine leadership we have received from our past Chairman, Herb Ellingwood, and to assure the committee that I plan to carry on his excellent management and leadership.

As an agency we think we are in very good condition. Our case processing time in over 99 percent of our regional cases is at the 120-day limit. We think we are probably the only agency in the Federal Government which can boast of that record.

Senator ABDNOR. It certainly will not compare with Congress.

Ms. JOHNSON. Because of the excellent senior staff that Chairman Ellingwood put together, the transition has been very smooth and we will continue implementing his policies and turn the agency over to a new Chairman in good condition.

IMPACT OF GOVERNMENTWIDE REDUCTIONS

Our fiscal year 1987 requests do not reflect any possible impact of Governmentwide reductions; that is, Gramm-Rudman. We have received a substantially increased number of telephone inquiries from agencies asking for advice on furloughs and potential reductions in force. If this continues, it could have an adverse impact on our current staffing. We hope to be able to continue to field these questions without any further augmentation. I thought I should bring it to the committee's attention that that is a potential problem we are facing.

Other than to say how great we are, I really do not have anything else to say. I think I should open myself up for any questions that you have, sir.

Senator ABDNOR. Thank you. I am sure the record stands for itself. The cuts caused by Gramm-Rudman, how did you absorb it? I mean, I don't want a detailed record of it, but just roughly.

Ms. JOHNSON. Painfully, very painfully. Basically for fiscal year 1986, through attrition and the resultant savings on salary and personnel benefits, we have been able to maintain our present budget level. For fiscal year 1987 we could be forced to make extreme personnel cuts. We hope that that will not be necessary because I know that you, more than anybody else, realize the necessity of keeping us from being in a pre-ATC posture where we were down on staff, down on budget, and then all of a sudden—the overwhelming caseload arrived. I think it is very realistic to assume that we will be the agency whose workload will be most hard hit by any Governmentwide reductions.

I think that with the hard work the staff has put in over the last 2 years to make us a model judicial agency and to get our processing time to where it should be, it would really be a terrible waste to be set back to the preair traffic controller caseload. So we hope that with your support that will not be necessary, Senator.

PERSONNEL COMPENSATION

Senator ABDNOR. Thank you. You state it very well. Can I ask you about your personnel compensation figures? They remain exactly the same as fiscal year 1986, and every agency that has come to us is asking for increases even though their personnel are not increasing.

Now, first of all, I want to thank you. How were you able to do it?

Ms. JOHNSON. We are just better than everybody else. We have an excellent staff. I would like to have our budget specialist answer.

Ms. SWIFT. I can also answer too, to some degree. I think we have had almost no turnover in staff. As a result, as she said this morning on the way up here, you'd have to die to leave the MSPB. We have almost no turnover. As a result, with a number of management efficiencies that our former Chairman had us participating in, we actually got better; I mean, such things as writing courses. If you have people, and work with them over a long period of time, you will have some success—which we have had. Because we have had money, to process ATC cases, the people have really gotten much better.

CASELOAD

Senator ABDNOR. You are obviously good negotiators, too. I have seen differences in judges. They have a huge caseload and a new one comes along and somehow is able to clean it up very efficiently.

Ms. JOHNSON. In addition, on appeal our cases are being upheld at the rate of 93 percent in the Federal circuit.

Senator ABDNOR. What percentage do come to the Board on appeal?

Ms. JOHNSON. I would say that approximately one-third are appealed to the full Board; for instance, in calendar year 1985 we processed about 7,900 cases. We have a projected caseload of 8,250 for fiscal year 1987, assuming no Gramm-Rudman impact which could double or triple that number very easily. And approximately 2,600, I believe, came to the board in fiscal year 1986, with 2,300 projected for fiscal year 1987.

Senator ABDNOR. Are those kind of stable figures?

Ms. JOHNSON. That is again based on no Gramm-Rudman impact.

Senator ABDNOR. We will see what happens. The Board's workload is projected to be about the same.

Ms. JOHNSON. Again, with no Gramm-Rudman impact, already we are seeing signs that we are going to be substantially impacted by it.

SERVICE INCREASE

Senator ABDNOR. Your services category has the biggest increase for 1987. What is it attributed to?

Ms. JOHNSON. You are talking about the types of case that we are handling. Let me see.

Mr. WADE. Mr. Chairman, the budget difference from 1986 to 1987 simply reflects the general inflationary expectation in 1987.

GS-11 TO GS-15 STAFFING

Senator ABDNOR. You have 203 or 57 percent of your people all within the GS–11 to GS–15 levels. What steps, if any, are you taking with regard to the GS–11 to GS–15 initiative.

Ms. JOHNSON. We are looking at ways to reduce our top grades. However, with the potential of an increased caseload, we also have to consider the fact that we have to keep as many experienced attorneys on board as we possibly can to handle any future caseload. We are primarily at this time dealing with it through attrition.

We are looking at a number of other options such as capping grades and eliminating certain grades if necessary. We do not have a final formula on what we will do on the higher grade levels. We feel very strongly, though, that in order to maintain the judicial excellence that we have achieved that we do have to maintain certain high grade attorneys, probably more so than other agencies.

Ms. SWIFT. We have also lowered the entry level grade for attorneys from a GS–11 to GS–9. We have had a freeze at the GS–15 level, unless you supervise other attorneys. We do not have new GS–15 standalone atttorneys. We still have some old ones, but we are not promoting anybody else to that rank.

Ms. JOHNSON. Right. And if we have do a reduction of the GS–15 nonsupervisory grades, we are still going to have to pay them at that GS–15 level for I think it is a total of 2 years. So it will be a paper reduction but not an actual dollar savings for quite awhile. We are looking at all the options possible without reducing the quality of our opinions.

Senator ABDNOR. But does it hurt the morale of the people working for you?

Ms. JOHNSON. That is another important point.

Senator ABDNOR. You are quite a salesman.

Ms. JOHNSON. It is easy when you have the best product.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Thank you. We will have other questions, I am sure, on the part of Senator DeConcini and ourselves. You will, if you do not mind, answer the question in writing.

Ms. JOHNSON. We would be very happy to provide them.

Senator ABDNOR. Thank you.

Ms. JOHNSON. Thank you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

QUESTION: Could you briefly outline how a case works its way through the system and the approximate period of time required at each level?

ANSWER: The appeal is received at one of eleven regional offices by the docketing Clerk who prepares a form identifying the parties to the appeal, the type of action appealed and any problems relating to jurisdiction and timeliness. The regional director then reviews and assigns the appeal to a presiding official. The appeal is docketed and an order is issued acknowledging receipt of the appeal, ordering respondent to file a response and providing information relative to the Board's procedures. This processing is completed within three days from receipt of an appeal.

The agency's response is usually filed within 25 days from the date of the regional office's initial order. If a hearing is required the presiding official will schedule a hearing and issue an order notifying the parties of the date, time and location of the hearing. In addition, the parties are advised as to what actions must be completed before the hearing. The prehearing order is usually issued within 30-35 days from receipt of the appeal.

From the date the appeal is filed until the date of the hearing, preliminary motions are filed and ruled upon by the presiding official. Such motions usually concern discovery of evidence, venue, and subpoena of witnesses.

Approximately 10-20 days prior to the hearing, a telephone prehearing conference is scheduled at which time the presiding official assists the parties in narrowing the issues to those actually in dispute, arriving at an agreement on facts not in dispute and identifying the witnesses whose testimony will be heard and the documents which will be offered into evidence. The presiding official will also explore the possibilities for settlement of the appeal and, when invited by the parties, will assist in arriving at a settlement agreement.

The hearing is usually conducted within 60-75 days from the filing of the appeal. The average hearing lasts approximately 4-5 hours, depending on the nature of the action appealed and the complexity of the issues. The length of the hearing is also affected by the relative experience of the representatives, including attorneys and union stewards. In the vast majority of cases, the record closes with the conclusion of the hearing. In some cases, the record will remain open for additional evidence or post hearing briefs.

The presiding official reviews the evidence, researches the law and drafts a decision on the appeal. The draft decision is reviewed by the regional director to ensure that all issues are addressed and that the findings of fact are supported in the decision by reference to the evidence and that findings of law are supported by citations to appropriate statutes, regulations or precedential cases.

The presiding official's decision is usually issued within 90 days, but no later than 120 days from the filing of an appeal.

After the issuance of an initial decision, any party to the appeal (or the Director of the Office of Personnel Management under limited circumstances set out at 5 U.S.C. 7701(e)(2)) may petition the Board for review within 35 days. The Board's regulations provide that a motion for extension of time to file the petition may be granted if the motion is supported by a showing of good cause. Additionally, a late-filed petition may be accepted if the petition shows good cause for its untimeliness. Thus, there may be a delay of 40 days or more after issuance of an initial decision before the Board receives a petition for review.

Upon receipt of the petition, the Clerk of the Board requests the administrative record from the regional office which issued the initial decision. The Board's regulations no longer provide that the Clerk of the Board will exchange the petition. However, the other parties are given 25 days from the date of service of the petition in which to file a response and/or a cross-petition for review. If a cross-petition is filed, the other parties have another 25 days from the date of service of that pleading to respond. Service is defined in the Board's regulations as mailing, as shown by the postmark date. At that point, or after receipt of the response to the petition for review if there is no cross-petition, the case is certified to the Board's Office of Appeals Counsel.

When a case is received in the Office of Appeals Counsel, it is logged in, dated for forwarding to the Board 50 days hence, and assigned to one of the four adjudication sections within the Office. The supervisory section attorney reviews and assigns it to an attorney for adjudication. The attorney reviews the record, does the necessary research, and writes a cover memorandum to the Board recommending the proper disposition of the case, and a decision which effectuates that recommendation. The decision is reviewed by the supervisory attorney and, depending on the nature of the decision, by the Assistant to the Director or the Associate Director and the Director. It is then forwarded to the Board Members for consideration.

Cases are reviewed by the Board Members seriatim and each case generally goes before each of the Members within a period of approximately three weeks. Each Member has an Executive Assistant who reviews the proposal and makes a recommendation to his or her Member. The Board Members then review the matter and vote on the case. If two of the three Board Members agree to issuance of the proposed decision, the case is forwarded to the Office of the Clerk for issuance. If they direct a revision of the decision instead, the case is returned to the Office of Appeals Counsel, where the attorney who wrote the original decision carries out the rewrite instructions. After review within the Office, the case is returned to the Board within 15 days for final approval. The Clerk issues the decision within 24 hours of receipt from the Board.

QUESTION: Your office has been very effective in its effort to adapt ADP to your process. Could you briefly outline what you have done.

ANSWER: BACKGROUND - Very early in its existence, the Board recognized that effective management required precise and controlled monitoring of the Board's appellate case load. The Board established processing time limits, production standards, and a system for monitoring and tracking cases through the system -- from initial appeal through the Petition for Review stage, and finally the courts. This initial tracking system was, at best, a rudimentary manual system, and it quickly became apparent that a more sophisticated system was needed. As a result, the Board developed an integrated information processing system, which provides not only case tracking, but word processing, electronic mail, legal research, and a variety of administrative uses, with the capability for future enhancements.

CASE TRACKING SYSTEM

All Board offices which process appellate jurisdiction cases are included in the case tracking system. Data is entered into the system at each step in the processing of cases from their initial receipt through final disposition. With the knowledge gained through experience, process times have been established and cases are monitored to identify any trouble spots. Where necessary, cases can also be shifted between offices to keep workload balanced, consistent with office staffing.

A variety of reports on pending and closed cases are produced and distributed on a regular basis. Based on these reports, weekly Case Inventory Review meetings evaluate the caseload to assure timely processing.

The case tracking system also prompted the establishment of a separate litigation tracking system which monitors cases in the Federal courts.

WORD PROCESSING

Crucial to the Board's new computer system was that it be "integrated" -- i.e., that equipment be compatible allowing all Board employees to tie into a single system for a variety of purposes. Thus, the same equipment provides case tracking and word processing. Attorneys use word processing to prepare draft decisions which allows for needed changes without retyping an entire document.

ELECTRONIC MAIL

Communications between the Board's various headquarters and regional offices have been simplified through a nation-wide electronic mail system. Requests for files, documents, and similar types of materials are transmitted electronically, reducing the need for written memoranda, reducing response times, and, ultimately, the cost of postage.

OTHER USES

The Board recently began to transmit time and attendance and payroll data electronically to the National Finance Center in New Orleans, cutting the processing time and reducing the potential errors in a paper system. In addition, a number of administrative uses have been developed by Board staff to include financial planning and projections, property inventory controls, and warehouse management.

FUTURE ENHANCEMENTS

In FY 86, three regional offices (Denver, San Francisco, and Washington, D.C.) began a test of a computerized commercial legal research capability on the in-house system. In addition, plans include electronic docketing and internal correspondence control.

SUMMARY

ADP has contributed enormously to the effectivenss of the Board's operations and activities. It provides the capability to monitor and track cases to ensure timely processing. It has reduced typing backlogs and assisted attorneys to meet production goals through efficient and effective use of available staff resources. Communications have been improved through electronic means, and further refinements promise even more benefits.

QUESTION: Could you give us caseloads by regional office?

ANSWER: In FY '85, the following cases were issued:

Atlanta	1,363
Boston	441
Chicago	992
Dallas	1,042
Denver	573
New York	820
Philadelphia	1,228
Seattle	393
San Francisco	1,509
St. Louis	588
Washington	948
	9,897

QUESTION: You indicate that the new RIF regulations may have a big impact on your caseload. To what can this projection be attributed, the new regulations themselves or something else?

ANSWER: Historically, new regulations are subject to challenges far more frequently then regulations which have been subject to extensive litigation. As we are mindful of this practice, we anticipate a greater workload based on the new RIF regulations.

QUESTION: Your 1984 SES Report found that many felt the SES had failed to meet its goals and that senior level employees are not interested in entering the SES. Briefly could you outline some of the problem areas? What might be done to correct the deficiencies?

ANSWER: We reported in the 1984 Report on the Senior Executive Service that 40 percent of midlevel employees surveyed in grades 13 through 15 indicated they would not join the SES if given the opportunity. The survey did not evaluate reasons for this attitude.

This report also noted that many executives felt some of the SES objectives had not been met. Many believed that the goals of protecting executives from arbitrary actions and providing for a system guided by the public interest and free from improper political interference had not been achieved. This perception did not conform with the number of reported incidences and may have been fostered by the extensive publicity on several prominent cases.

When this survey was taken there was a ceiling on executive pay and a limitation on the number of executives eligible to receive bonuses. In light of this, it is not surprising that a large number of executives believed that the goals relating to the SES compensation system had not been achieved. Positive changes have been implemented in the SES compensation system since the survey was taken--the ceiling on executive pay has been raised and the number of executives eligible for bonuses increased.

QUESTION: Your request for FY 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total were applied to your 1987 request, what would happen?

ANSWER: The lesser appropriations level would make it more difficult for the Board to respond to any increase in workload that might occur as a result of actions taken by individual agencies in response to the Gramm-Rudman-Hollings Act or the revised reduction-in-force regulations recently published by the Office of Personnel Management. Any significant increase in workload would likely increase the time required to completely adjudicate an appeal, and result in a new backlog of cases which would make it more difficult for individual agencies to efficiently manage their personnel and financial resources.

QUESTION: Would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

ANSWER: The Board is able to live with the reduction in FY 86 because we instituted a limited hiring freeze and because certain senior positions, such as the Chairman's and Managing Director's, have been vacant for a part of the year. Many vacancies will need to be filled before the beginning of 1987, particularly if additional workload is generated by either Gramm-Rudman-Hollings or the new regulations issued by the Office of Personnel Management on reduction-in-force. In addition, the Board expects to have the Chairman's position as well as other senior staff positions filled before FY 1987. For these reasons, most of the savings before were one-time in nature and are not expected to recur in 1987.

QUESTION: Have you reached the 135 square foot goal? If not, why and what is your target date?

ANSWER: The Board has been carrying out a space reduction program which has reduced the occupied space by over 30,000 square feet since October 1983. The Board's utilization rate is approximately 203 square feet per person. However, GSA recognizes that portions of each agency's space is used for public purposes. Such space is identified as supplemental space, and is not included in computing a utilization rate. We have submitted to GSA what we believe represents a reasonable supplemental space figure. If it is accepted by GSA, the Board's utilization rate for regional offices will be approximately 155 square feet per person and Headquarters will be 157. During FY '86 and '87, we will continue to reduce space in the agency as appropriate.

OFFICE OF THE SPECIAL COUNSEL

STATEMENT OF K. WILLIAM O'CONNOR, SPECIAL COUNSEL

ACCOMPANIED BY:

H. ALMA HEPNER, DIRECTOR OF CONGRESSIONAL AND PUBLIC RELATIONS

WILLIAM E. CALDWELL, MANAGING DIRECTOR FOR OPERATIONS

INTRODUCTION OF ASSOCIATES

Senator ABDNOR. K. William O'Connor, Special Counsel, will present the statement for the Office of the Special Counsel. It is good to have you back.

Mr. O'CONNOR. Thank you very much. I have with me, if I may, on the right my Director of Congressional and Public Relations, Alma Hepner; on my left is the Managing Director For Operations of the Office of Special Counsel, Mr. Caldwell.

PREPARED STATEMENT

Senator ABDNOR. Mr. O'Connor, you probably have been listening. We are not very demanding here of a long statement. It will all go in the record. Your statement is not long to start with. Why do you not just summarize and we will place your entire statement in the record.

[The statement follows:]

STATEMENT OF K. WILLIAM O'CONNOR

Mr. Chairman and members of the subcommittee: Please let me thank you for inviting me here today to discuss our budget request for fiscal year 1987.

Consistent with the administration's budget, the requested budget authority for fiscal year 1987 is $4,640,000 with 83 FTE positions. This represents an increase of $46,000 over the fiscal year 1986 estimated appropriation of $4,594,000 and maintenance of the current year FTE level.

By statute, OSC is required to investigate, and if evidence warrants, to prosecute all allegations of prohibited personnel practices, prohibited political activity, arbitrary or capricious withholding of information under the Freedom of Information Act and any other activity prohibited by civil service law, rule, or regulation. The office is specifically charged with providing a safe channel through which disclosures of waste, fraud, and abuse may be made, and with protecting whistle blowers from reprisal.

During fiscal year 1985, examination and investigation actions were completed on almost 85 percent of the total number of matters and cases processed during the year. In fiscal year 1986, action is expected to be completed on 1,597 matters of a total 1,903 matters (including the 316 matters and cases carried over from fiscal year 1985).

Also during fiscal year 1985, 50 referrals of whistle-blower disclosures were made to agency heads under the statute, and 65 informal referrals were made to agency inspectors general. Some of the results of these referrals ranged from better utilization of Veterans' Administration police officers to the suspension of $122 million in payments to a subcontractor at the Department of Defense. Based on current trends, it is projected that 53 statutory referrals and 70 informal referrals will be made during fiscal year 1986. It is further projected that 60 statutory referrals and 75 informal referrals of such allegations will be made in fiscal year 1987.

The successful accomplishments realized in fiscal year 1985, resulted from further refinement and consistent implementation and application of office policies and procedures.

The modified complaints processing structure which provides for centralized front-end review of all new complaints and allegations was fully implemented in fiscal year 1984 and further refined in fiscal year 1985. This system has materially aided in reducing the average time required to resolve investigative matters from 141.6 days in fiscal year 1984 to 78.2 days in fiscal year 1985. A total of 316 matters and cases were carried over from fiscal year 1985. Of these, 21 were litigation cases; 251 were matters pending preliminary inquiry, investigation or final legal review; 5 were informal action cases; and 39 were pending whistle-blower disclosure matters. During fiscal year 1986 (as of March 6) 7 new litigation cases have been initiated; 509 investigative matters (of 837 carryover and new matters) have been closed; and 43 whistle-blowing disclosures have been referred to the agencies under the statute or informally. Also, eight litigation cases have been closed and 15 agency reports on whistle-blowing disclosures have been received.

The objective of the office is to deal properly and promptly with each allegation or complaint received. To this end, each complainant is contacted personally to assure that the nature of the allegation or complaint is correctly and completely understood. Unlike some law enforcement agencies, OSC has no discretion as to whether it will investigate a matter. Public Law 95–454, 5 United States Code 1206(a)(1), requires, "the special counsel shall receive any allegation of a prohibited personnel practice and shall investigate the allegation to the extent necessary to determine whether there are reasonable grounds to believe that a prohibited personnel practice has occurred, exists, or is to be taken." In that light, priority is given to investigating matters with patent prosecutive merit. Emphasis continues to be given to resolution of all matters through appropriate investigation, and initiation of prosecution (when found warranted) or declination of prosecution within 90 days of receipt of such matters, and appropriate disposition of clearly nonmeritorious matters and matters not within the jurisdiction of the office within 30 days of receipt.

In order to ensure that employees are aware of the functions of the OSC and that a responsive relationship is maintained with the Congress, the public, and the press, I continue to emphasize our ongoing outreach program.

During fiscal year 1985, the Office of Congressional and Public Relations distributed over 68,000 copies of OSC informational materials to the public and Congress. This represents a substantial increase in outreach activities over the previous fiscal year. In addition, the office responded to an average of 300 press and congressional inquiries per month, and produced and dispatched some 1,180 letters to the press, Congress, and the public. Automated systems continue to be used to promplty and accurately track matter-related inquiries from Congress and the executive branch. Continued emphasis on outreach and responsiveness is planned in fiscal year 1986.

The net effect of administrative independence from the MSPB has been increased efficiency, responsivenss to management needs and improved control of administrative operations. Further improvement of the OSC computer system was achieved to provide more reliable, comprehensive and useful management information in a more timely manner. The new Planning and Oversight Division was established to improve and strengthen the overall planning, documentation of policies and procedures, internal control and financial management systems, systematic review of OPM rules and regulations, planning of special inquiries into systemic merit system abuses, internal training, and to conduct personnel security clearance program operations.

At the current budget set by the administration, we are able to discharge the responsibilities vested in the OSC by Congress. Any reduction by Congress in the administration's plan would place a severe strain upon our ability to carry out the statutory law enforcement scheme designed by Congress for execution by OSC which includes the variety of activities I have described to you today.

This concludes my formal statement which, along with our budget justification, summarizes the need for our budget request of fiscal year 1987 of $4,640,000 as submitted by the President.

I would be pleased to answer any questions that you or other members of the subcommittee may have at this time.

SUMMARY STATEMENT

Mr. O'CONNOR. Thank you, Senator Abdnor. The statement being in the record, my statement can be very, very short, and I appreciate you putting it into the record.

What I am suggesting in the statement today is that we can and will continue to execute the mission of the Office of Special Counsel assigned by the Congress through fiscal year 1987 with the savings required by the constrictions and which are being applied to the office with no loss of efficiency and with a continued effectiveness as we have in the past.

The estimated workload is likely to increase perhaps as much as 5 percent, but the cost to function will not. The reasons for the economies in function are basically that personnel costs are being suppressed. During fiscal year 1986 I have eliminated SES bonuses and I have eliminated all cash awards. That does not sound like a lot to do, but in a small agency of 84 people or so it is a fairly substantial change because 5 of the people are SES.

Then in addition to that we have two or three areas of control of costs. One of them is that it had been my practice to send two agents to conduct investigative activities in order to have always a witness besides the person who was actually conducting the interview and because often two heads are better than one.

We have changed. We now usually send only one agent unless it is a very critical interview. That cuts down the cost and allows us to maintain pace without increasing staff.

Senator ABDNOR. Has that presented any problems?

Mr. O'CONNOR. Not yet and I hope it will not. Today I have a very senior executive in Africa conducting an interview by himself. It is expensive to go to Africa both in terms of time and fare, but it was a whistle-blower case and it was required that we do it.

I would like to have had two people there, but I could not justify to myself the extravagance of the cost of two flights, and so we sent one man, but I sent the best man we have, and that means my senior executive structure is temporarily diminished. If he does not get malaria or some other dread disease, it will only be a short while.

Senator ABDNOR. How long will that take? How many days?

Mr. O'CONNOR. Well, 3 days out and 3 days back, sir, 30 hours in the air, and it will take him 1 week on-site. So he will be gone, if he does not take any time for recuperation en route back, he will be back in 10 days from the time of departure. He is planning to leave on Saturday from there to return. He left on Sunday on his own time to go out.

With that address of persons to problems, we can effect significant economies. Another thing we have done is it had been my practice to have transcripts made of every interview by a court reporter, you see, and that is costly because it is so much per page, as you know. So what we have done is eliminate that practice except in the most extraordinary situations, and instead use tape recorders. If someone wants a copy of what they have said, we will dupe the tape and they can have a duplicate copy of the tape rather than a transcript. That has saved us some money. There are a few other small savings that we have been able to effect, but that is basically the way it is operating. Basically travel and personnel costs are the cost functions of this operation.

Senator ABDNOR. That is pretty much the way you have absorbed the cuts this year.

Mr. O'CONNOR. Yes, sir.

Senator ABDNOR. Would you please detail it later on for our records? It sounds like you are doing a fine job of trying to make the most of it.

Mr. O'CONNOR. Thank you, Senator. I would like to say the compliment the Senator has paid is due to the staff of this agency. My term runs out on June 3. So I am in a position to say that I am practically finished with this appointment. I have to say that the staff, in the nearly 4 years I have been there, has performed in an extraordinary and admirable manner. The leadership has been outstanding by the staff and the executives who are there have done very well. And the record shows it.

In the period of the 4 years that I have been there, there have been two cases lost and about—and I am talking about substantive matters—31 filed and motions that have been tried. In the 45 months that the office existed before this last 42 months there were six cases filed and they were all lost. It is a big difference and it is because we have a disciplined staff of experienced and mature people who are, I think, dedicated to carrying out the mission that Congress has assigned.

Many of them are retired military and that is another savings because I get a retired colonel or a reserve or retired Air Force colonel for maybe half price. And so I have a talented man who may be 55 or 60 years old who has a lot of steam and a lot of knowledge and a lot of contacts and he can do a lot for us. We have representation like that from Secret Service, from the Internal Revenue Service, from the District of Columbia Internal Affairs Police Department, from most of the surrounding counties, and from a variety of other law enforcement areas.

A pension person is far from used up and very valuable to us.

Senator ABDNOR. You have some valuable background material added to your whole office.

Mr. O'CONNOR. We have found them to be a great resource, sir.

Senator ABDNOR. Your SLUC, for the record, to what would you attribute the increases?

Mr. O'CONNOR. It is unique. I had a little hard time with that myself. I think wall dividers is the answer. My managing director launched on a campaign to eliminate the cost of office space by using these mobile partitions. They kind of look like rugs on the wall. It is a very effective thing. We now have found that we can put four people in a room that used to only have one person in it, maybe two, and the sound deadening effects of the modular partitions are so successful that they can all carry on telephone conversations and not overhear each other. That saves a lot of SLUC and it has been a really effective way to accommodate the requirements.

Senator ABDNOR. You just kept the same space and added more people.

Mr. O'CONNOR. We have also decreased the number of people. This past year we have experienced a 3-percent reduction in work force from 86 to 84 people, and we have had no space increase and we have gotten rid of some space that was surplus.

Senator ABDNOR. A decrease: I am sorry I suggested it was an increase.

Mr. O'CONNOR. I saw a blanch on my left.

Senator ABDNOR. I will read my notes more carefully. Most of your complaints you are able to settle, are you not?

Mr. O'CONNOR. Well, most of them are without merit in terms of ultimate analysis, although we investigate all of them. Those which have merit very often on the corrective action side, a telephone call and a conversation with an executive of an agency takes care of the problem.

On the disciplinary action side, we found an increasing trend for an agency to say well, you know, that is the way it is. Let us take the action. We have found many have done that. Now, there are some where it does not occur, and there are some where frankly the agency feels—there is a case we just tried this week involving the regional director of an agency in Boston.

The agency did not feel they could take disciplinary action without serious internal consequences and they were kind of glad to have us do it. But, generally speaking, we have found that agency response has been excellent and that many of the matters that might once have involved us in litigation no longer do so.

Senator ABDNOR. Very good. When you do have one that goes to the boards, how long does it take?

Mr. O'CONNOR. From drink to swallow is sometimes a long time, but it is not the board's fault, I am sure, and it is no one's fault. It is just the process. I would say if I filed a case today and it was a disciplinary action case, it might be 2 years before it comes out of the sausage-making machine of the U.S. Court of Appeals. The board would assign it immediately for hearing. It would be tried within 90 days by the administrative law judge. Ninety days after that his opinion would be out. I would say 90 days after that briefs would be in and the board would have it. That is 270 days from filing. The board is on a 120-day turnaround period. So that would be 390 days when it got out of the board: I would say, therefore, about 1 year from filing to finish in the board.

But after it gets out of the board, it goes to the U.S. Courts of Appeals for the various circuits, and there calendars, as you know, are compressed with many important matters and they have to give criminal matters priority. So ours come along and when they get decided, it might be 1 year from the time that the appeal was noted. So I would say a 2-year max, 1 year of it being in the process of the U.S. courts, which is beyond the board's control.

Senator ABDNOR. What about your caseload for 1987.

Mr. O'CONNOR. I would say about the same. We have noticed a slight increase this year from last year, and the greatest increase is not numeric. It is in quality of complaints. We have noticed a significantly greater number of meritorious complaints lately.

My projection into 1987 would be that maybe we would have 5 percent gross numbers over 1986, but we are talking in such small and finite numbers that 5 percent of 2,000 is another 100 matters. It does not really make a significant difference. The front-end processing system is efficient now. We have experienced attorneys, experienced personnel, and experienced investigators running it and that takes care of most of the volume.

The numbers that are going to be found in the investigative clutch at any particular time are going to run about 100 to 150, and they are going to take time to do.

Senator ABDNOR. Your backlog?

Mr. O'CONNOR. The backlog, sir, is, I would say, at about 300 at any one time, and the aging of the backlog is going down. The last time I was before you, sir, the backlog was something just under 300, and the aging was an average of, I think, 98 days. Now I have a little over 300 and the aging is a little under 93 days. So it has been a 5-percent decrease in age and a slight increase in volume.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Let me congratulate you. It sounds like you have a fine and efficient operation. We thank you for appearing today. We will be submitting some questions to you in writing. We thank you for coming.

Mr. O'CONNOR. Thank you very much, Senator Abdnor. I appreciate very much the courtesy of the committee.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question. Your request for fiscal year 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen?

Answer. The fiscal year 1987 budget request for the OSC has been adjusted by OMB to meet the Gramm-Rudman-Hollings targets in accordance with the administration's commitment. If the ultimate congressional budget authorization changes the administration's request and requires across-the-board cuts, OSC could only respond after advice of the extent of any such cuts. The execution of the OSC mission can be configured within any budget figure approved by the Congress; the budgt level determines the affect upon OSC output. The current rate of funding is the minimum level at which we could maintain our current output.

Question. Would it be too much to assume that if you lived with the reduction in fiscal year 1986, you could certainly utilize that level as a base in 1987?

Answer. If continued cuts are imposed, OSC output would decrease, the processing rate of whistle blowing and prohibited personnel practices complaints would be prolonged, and the quantity of detailed case investigation would be curtailed. The fiscal year 1987 passback figure received from OMB includes the Gramm-Rudman-Hollings target and an inflationary adjustment. Anything less would be tantamount to a cut.

Question. Have you reached the 135 square foot goal? If not, why and what is your target date?

Answer. OSC reached the 135 square foot target goal over 1 year ago based upon GSA's formula for space utilization. In June 1985 GSA performed a space audit. The formula were different (based upon measurements from the outside rather than the inside walls). The results were an adjustment from 135 to 139 square feet; but there was no change in the square footage of OSC space. GSA found the space was well utilized and recommended no reduction.

ADVISORY COMMITTEE ON FEDERAL PAY

STATEMENT OF MARTIN L. DUGGAN, CHAIRMAN

ACCOMPANIED BY LUCRETIA DEWEY TANNER, EXECUTIVE DIRECTOR

INTRODUCTION OF ASSOCIATE

Senator ABDNOR. Our next witness is Mr. Martin Duggan, Chairman of the Advisory Committee on Federal Pay. We welcome you. I guess you have heard the testimony of the other witnesses so you know how we are operating here.

Mr. DUGGAN. Yes, Mr. Chairman. We will certainly telescope our remarks.

Senator ABDNOR. Thank you.

Mr. DUGGAN. With me is Ms. Lucretia Dewey Tanner, the Executive Director of the Advisory Committee on Federal Pay. Last year, when we had the privilege of appearing before your honorable committee, we were in the process of drafting a special spring report to the President. We had the advantage of getting expert assistance from Members of Congress, people in the administration, and the work force, academia, unions, and so on, and with your permission we would like to enter that report along with our annual report to the President as part of the record.

Senator ABDNOR. Fine. We would love to have it.

EXPANSION OF THE BUREAU OF LABOR STATISTICS PATC SURVEY

Mr. DUGGAN. Now, the most noteworthy development since that time has been action to satisfy a continuing concern of the pay agent, the pay agent being the Secretary of Labor, the Director of the Office of Budget and Management, and the Director of the Office of Personnel Management, over the scope of the survey conducted by the Bureau of Labor Statistics. These data determine the pay gap between the Federal work force and the private sector.

Now, this step has been taken: the pay agent has asked the Bureau of Labor Statistics to undertake an expansion of its 1986 survey and include smaller sized establishments, those with 50 or more employees. This is the first step of the expansion.

In 1987 State and local government employees will be surveyed. This public sector information will not be included in the pay data because of the restrictions of the 1970 act, which limits comparisons to private firms. The last step of the expansion will be to include establishments with as few as 20 employees.

Our committee welcomes this development because it is one of the recommendations in our special spring report of last year.

NEED FOR LOCALITY PAY

A continuing concern of ours and one which we hope will receive attention is that consideration be given to the development of a locality pay system and total compensation comparability.

One of the criticisms most often heard by our committee members, who are three people from the private sector in different parts of the country, is the failure to pay the going rate in a community. A system that permitted flexibility, would be more agreeable to the public, in our view, and tend to reduce resentment expressed against a perception out there—not ours, you understand—the perception that Federal workers in many cases are overpaid and underemployed.

Senator ABDNOR. Depending on what part of the Government you are talking to, you could have a discrepency in the same kind of work people might be doing in one part of the area to the other. Would that affect everybody in that category?

Mr. DUGGAN. Undeniably it would be controversial within the work force, but the proposal that we are suggesting is that, for instance, a clerk in a rural Midwestern community, Joplin, MO, let us say, presently paid at the same level as a clerk in Washington, DC, or New York City is not reflected in pay standards in the private sector. A common complaint is that people in Government should be paid the going rate which applies to locality.

As I say, we are not alone in making this recommendation. There is a history of recommending it.

ADVISORY COMMITTEE FISCAL YEAR 1987 BUDGET REQUEST

As to our budget request, we are proud of the fact that we are the smallest agency in Government. I mentioned there are only three private citizens serving on our committee, and we have two General Schedule employees as staff workers.

Our budget request for 1987 is $229,000. This covers salaries and travel expenses of staff and committee members when they are on committee business as well as rent and operating expenses of our headquarters office. Historically, our committee has been frugal and, in fact, has returned money to the Treasury on an annual basis.

PREPARED STATEMENT

I would be happy to answer any questions that you have, Mr. Chairman.

[The statement follows:]

STATEMENT OF MARTIN L. DUGGAN

I am Martin L. Duggan, Chairman of the Advisory Committee on Federal Pay. Thank you for inviting me to appear before you today. I would like to present a summary statement about the committee's activities and concerns, in addition to the budget request for fiscal year 1987.

First, let me provide a brief background on the Advisory Committee on Federal Pay. This committee was established by the Federal Pay Comparability Act of 1970 (Public Law 91-656) as an independent body and adviser to the President on pay matters. The committee's recommendations apply to pay affecting approximately 1.4 million Federal employees covered by the General Schedule, those employed in the Department of Medicine and Surgery of the Veterans' Administration, and the Foreign Service. The committee is composed of private citizens who are appointed by the President to serve 6-year staggered terms. Day-to-day activities of the committee are carried out by two General Schedule staff employees.

On August 20, 1985, the Advisory Committee submitted its annual report to the President. The report included a recommendation stating that a pay increase of 4.7 percent was warranted and should become effective October 1985. This 4.7 percent is the amount of increase white-collar employees in the private sector received in the June 1984–June 1985 period, as measured by the Bureau of Labor Statistics' employment cost index. I would like to request that the committee's 1985 report be made part of the official record.

The committee's recommendation differs from the findings of the pay agent (the Directors of the Office of Management and Budget and the Office of Personnel Management and the Secretary of Labor). In their separate report to the President, they reported that a 19.15-percent pay gap existed. The pay agent's report has been critical of the pay survey over the past few years for not reflecting wages in the total economy. As a result of the controversy over the survey scope, the pay agent has asked the Bureau of Labor Statistics to undertake an expansion of its 1986 survey and include smaller sized establishments, those with 50 or fewer employees. This is the first step of the expansion; in 1987, State and local government employees will be surveyed. This public sector information will not be included in the pay data because of the restrictions of the 1970 act, which limit comparisons to private firms. The last step of the expansion will be to include establishments with as few as 20 employees. The Advisory Committee is hopeful that this expansion can proceed as scheduled.

Last year, the Advisory Committee also issued a special spring report to the President which discusses a number of issues dealing with Federal pay and compensation matters. Since this is a comprehensive review of a number of pay and compensation matters, I would like to just mention a few. As the report points out, the October 1977 pay adjustment was the last time the pay agent's and this committee's recommendations were implemented. Thus, in the years since 1978, through 1986, or a 9-year period, adjustments have not been based on any link to the private sector. It is my belief that the current system should be reevaluated. Recommendations that have been made by us and others over the years should be adopted.

Among the changes that should be given priority consideration are the development of a locality pay system and total compensation comparability. Briefly, one of the criticisms most often heard beyond the Potomac is the Government's failure to pay the going rate in a community. A system that permitted this flexibility would be more agreeable to the public and tend to reduce the resentment against Federal workers, a very needed step. Second, we recommend that total compensation comparability be considered, that is, having wages comparable to the private sector and, separately, adjusting the benefit package to approximately those provided by business.

Recently serious consideration has been given to expanding the Navy's China Lake proposal. China Lake is a designation of a demonstration project conducted at two installations—the Naval Ocean Systems Center in San Diego and the Naval Weapons Center in China Lake, CA. This system is a more flexible pay plan that compresses the 18 General Schedule grades into 5 and includes an apprentice level. The broad pay banding approach permits flexibility in paying the newly recruited and rewarding the long-term employees. While the committee favors the use of demonstration projects, including one to determine the workability of locality pay, any additional demonstration projects should be designed to permit a careful examination of both costs and benefits.

The Advisory Committee was fortunate in having advice and input from a large number of people with expertise in Federal pay and compensation matters. We included their views in the spring report, and I would ask permission to have this report also made part of the official record.

Let me now turn to the Advisory Committee's 1987 budget request. Our budget requirements vary little from year to year. In fiscal year 1987 we seek $229,000. This amount covers salaries and travel expenses of staff and committee members when they are on committee business, as well as rent and operating expenses of our headquarters office. The committee has always been frugal and has exercised financial restraint. Our funds cover the bare necessities and there is a minimum of discretionary spending included in this amount.

In the coming year, we anticipate that a great deal of discussion will center on pay and benefits of Federal workers and our committee will devote its efforts to analyzing the current issues and be prepared to offer its recommendations.

This concludes my remarks and I will be happy to answer questions.

BUDGET INCREASE

Senator ABDNOR. Thank you. The only area where you have a significant increase over fiscal year 1986 is in personnel compensation; is that correct?

Mr. DUGGAN. That would be correct, yes, sir.

Senator ABDNOR. Is this due to step increases?

Mr. DUGGAN. Is that correct?

Ms. TANNER. This is due to projected pay increases and the normal merit increases, if that is appropriate. We anticipate no further increase in staff. We are authorized three staff persons and we operate with two people.

Senator ABDNOR. While you are at it, too, will you give us in writing how you applied the Gramm-Rudman-Hollings cut.

Mr. DUGGAN. Our main way we have handled that is by not hiring the additional staff person we are authorized to have.

Senator ABDNOR. You do not have many to start with.

Mr. DUGGAN. Two of the best. I heard some bragging today about how efficient people are. I do not think anybody can beat our track record. If you cut us one-half we are going to be down to the inseparable.

PAY GAP

Senator ABDNOR. Am I correct in assuming that the pay gap is increasing?

Mr. DUGGAN. According to interpretations, yes, sir. The pay agent, based on the data it was provided with last year, reported that a 19.15 percent pay gap existed between Federal employees and those in the private sector.

Senator ABDNOR. In the past year?

Mr. DUGGAN. Yes, sir; now, it does not mean that the pay agent endorses this finding, you understand. They are serving as a conduit for passing on this information. Our own recommendation, our committee's recommendation to the President was that a 4.7-percent increase was warranted, and this was based on measurement by BLS of the employment cost index, a figure which applied to the private sector. So our recommendation tried to keep the gap from widening and fully appreciating that there was no way on Earth that a 19.15-percent pay increase was going to be granted in a year when a 5-percent pay cut was the original recommendation of the administration.

Senator ABDNOR. In 1987 there will be some kind of a pay increase.

Mr. DUGGAN. Well, there is a 3-percent pay increase recommended, but also a 2-percent increase in contributions to the retirement fund.

Senator ABDNOR. Was that taken into your study?

Mr. DUGGAN. Well, you see, we have not drafted our report to the President for fiscal year 1987 as yet because our calendar of events calls for us to hold hearings in August and to issue our report to the President at that time. So we are gathering information continually. But we are not prepared to issue our recommendation as yet.

Senator ABDNOR. Thank you both.

Mr. DUGGAN. Thank you. We appreciate your hospitality.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. There will be questions in writing.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question: How is the Advisory Committee on Federal Pay allocating cuts required under Gramm-Rudman-Hollings?

Answer: The Advisory Committee is authorized to have three General Schedule employees. We currently have two and we do not plan to fill the vacancy. Funds that would go to pay for that third position will be used to meet the new budget reduction requirements.

Question: Mr. Duggan, I have only one real quick question, but it goes to the core of your mission.

Your agency was established back in 1970 to advise the President on Federal pay matters. In some cases, the President has accepted your recommendation but in many cases he has ignored them, it appears. OMB and OPM and the Labor Department also make recommendations regarding Federal pay.

Wouldn't it make sense to abolish the Advisory Committee on Federal Pay in FY 1987 and allow pay issues to be resolved through the give and take of negotiations between labor unions; the Labor Department; OMB; OPM and the President's budget advisers? I imagine that OMB now plays a larger role in setting the percentage pay increase for Federal workers than does the Advisory Committee.

Answer: Under the Federal Pay Comparability Act of 1970, the Pay Agent is responsible for determining the pay comparability adjustment required for Federal white-collar workers based on comparisons with the private sector. The Pay Agent (composed of the Directors of the Office of Management and Budget and the Office of Personnel Management and the Secretary of Labor, who was added by a 1977 Executive Order) is required to submit an annual report to the President. The Act also specifically requires the Advisory Committee on Federal Pay to present its independent report to the President. The Advisory Committee's mandate is to review the Pay Agent report, meet with representatives of the Federal Employees Pay Council, other Federal employee representatives, and others to determine their concerns and these, in turn, are reflected in the Advisory Committee's reports.

The Advisory Committee is the only governmental group that the unions and professional associations now meet with, aside from Congress. Although the Act calls for the Pay Agent to meet with the Federal Employees Pay Council, meetings on an ongoing basis have not been held since 1978. The unions currently have no voice in the pay setting process and the Advisory Committee is their only conduit to the President. However, the Advisory Committee would welcome greater employee participation in the process, just as the law intended.

Last year, the Pay Agent found that a 19.15-percent pay gap existed between Federal and private rates. As you know, the original FY 1986 budget called for a 5-percent pay cut and the final decision was to freeze wages. On the other hand, the Advisory Committee recommended that a 4.7-percent increase was warranted, based on gains made by the private sector white-collar workers, reflected in the BLS Employment Cost Index. We believe that our advice best serves the Federal worker and the general public.

Abolishing the Advisory Committee requires a change in the 1970 law and apparently neither Congress nor the Administration wants to amend, modify, or substitute it with a new pay setting process at this time.

If you are seriously suggesting that a government committee be abolished because its advice is not always heeded, may I ask if you would eliminate parents because their advice often is rejected by their children.

Question: The Committee has been working on a study that is due out this spring. Am I correct? Are there any findings you can share with us at this time?

Answer: The Advisory Committee prepared a spring 1985 report that was transmitted to the President in August 1985. Attached is a copy for your Committee's review. Rather than attempt original research on Federal pay and compensation, now being done by the Bureau of Labor Statistics and private firms, the Advisory Committee sought the advice of organizations and individuals with expertise on these issues.

We had the pleasure of meeting with representatives of labor unions, employee associations, government officials, research organizations, and the media. Many of these people have years of experience in Federal pay and benefit matters.

Let me share with you just a few of their observations and suggestions. Concern was expressed about the current pay setting process and the repeated use of the alternative pay plan. One recurring theme for remedying the dilemma is to separate the General Schedule for professional and technical categories for occupations recruited nationwide with a separate system for clerical employees to reflect local labor market conditions.

Another recommendation is to adopt the concept of total comparability, that is, compare pay and benefits separately with those in the private sector.

One of the chief concerns with the annual Professional, Administrative, Technical, and Clerical survey is the coverage of small firms and industries not now included. BLS has begun a 3-year expansion to cover small firms and the public sector as well, which could lay to rest the question of faulty data. These are only a few of the many comments we received, and the attached report includes a full discussion of the other issues.

Question: Your request for FY 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen?

Answer: The Advisory Committee's FY 1987 budget request is based on normal operations and does not reflect any projected cut based on the Gramm-Rudman-Hollings deficit reduction effort. At this time, there is no estimate of the amount that agencies will be asked to cut from their budgets.

Question: Would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

Answer: The Advisory Committee's FY 1986 budget is currently $201,000, an amount that sustained a cut first by Congress, then by the additional sequestered 4.3 percent required under the deficit reduction act. If the Advisory Committee is required to use this as a base and then sustain further reductions in FY 1987 because of the Gramm-Rudman-Hollings law, there could potentially be problems, depending on the amount to be cut. Since we do not know the magnitude of the FY 1987 cuts yet, it is difficult to speculate on the actions that would be necessary.

Question: Have you reached the 135 square foot goal? If not, why and what is your target date?

Answer: One of the points made by most small agencies, including the Advisory Committee on Federal Pay, is the difficulty in reaching such a goal. This issue was brought to the attention of the General Services Administration, which has contracted with a private firm to do a special study of the auxiliary space requirements of small agencies. As you know, the 135 square foot allowance per person does not take into account the need to provide a reception area, conference or meeting space, file and reference requirements, reproduction equipment, or provide for any flexibility.

The question we pose to GSA and the Appropriations Committee "Is the Chairman of the Advisory Committee, a Presidential appointee who meets with government officials, employee representatives, the media, and others, restricted to 135 square feet?" In a small agency with few employees there is no flexibility to provide adequate space for the Committee Chairman or its members.

FEDERAL LABOR RELATIONS AUTHORITY

STATEMENT OF JERRY L. CALHOUN, CHAIRMAN

ACCOMPANIED BY:

- HENRY B. FRAZIER, III, MEMBER
- JOHN C. MILLER, GENERAL COUNSEL
- JACQUELINE R. BRADLEY, EXECUTIVE DIRECTOR/ADMINISTRATOR
- GEORGE B. BAILY, JR., DIRECTOR, OFFICE OF FINANCIAL AND PROGRAM ANALYSIS
- HOWARD W. SOLOMON, EXECUTIVE DIRECTOR, FEDERAL SERVICE IMPASSES PANEL

INTRODUCTION OF ASSOCIATES

Senator ABDNOR. Our next and final witness is Jerry Calhoun, Chairman of the Federal Labor Relations Authority, and John Miller, the Authority's general counsel. It is nice to see you again.

Mr. CALHOUN. Thank you very much, and I do appreciate very much this opportunity to discuss with you the fiscal year 1987 request for the Federal Labor Relations Authority. With me today—I think you know most of the individuals with me—Mr. Frazier, member of the Authority; Mr. John Miller, our general counsel; Ms. Jacqueline Bradley, our new Executive Director and Administrator; accompanying Mr. Miller is George Baily, who is his Director for Financial and Program Analysis; and, Mr. Howard Solomon, who is sitting in for Chairman Brewer of the Federal Service Impasses Panel.

BUDGET REQUEST

Our fiscal year 1987 request for $17,064,000 and 277 full-time permanent positions will, I believe, provide the necessary funding and staffing to achieve our fiscal year 1987 program objectives. Our request for the 277 full-time, permanent positions represents a 12 position reduction from our current level. Although this reduction will be felt, we are confident that we will be able to execute our program within the requested funding levels.

On a personal note, I am delighted to be before you today and indeed honored to be able to serve as a member of the Authority and as its Chairman, and I certainly would like to be on record stating that I am committed to the objectives of the Authority, as is this committee, insofar as pursuing these goals that affect the efficient operation of the agency. I look forward to working with all of you toward that end.

PREPARED STATEMENTS

I have no other formal remarks and I believe my formal statement submitted earlier will be reflected in the formal record.

Senator ABDNOR. Very good. Mr. Miller.

Mr. MILLER. Thank you, Senator Abdnor. I also have a formal statement.

Senator ABDNOR. It will be made a part of the record.

[The statements follow:]

STATEMENT OF JERRY L. CALHOUN

Mr. Chairman and Members of the Committee, I appreciate this opportunity to appear before you for the first time to discuss the FY 1987 appropriation request for the Federal Labor Relations Authority (FLRA).

Since my appointment as Chairman of the FLRA this past December, I have had the opportunity to work closely with many employees at the Federal Labor Relations Authority. I must say that I am favorably impressed with both the technical competence and the sensitivity of our staff in addressing the issues that are before us. As I have told the staff on several occasions, I bring to the FLRA a resolve to administer the provisions of the Labor-Relations statute in a fair and equitable manner. Our overriding goal during my term as Chairman will be to provide timely, clear, and fair decisions.

The request before you is for $17,064,000 and 277 full-time permanent positions. This represents an increase of $734,000 from the sequestered FY 1986 level. The 277 full-time permanent positions is a 12-position reduction from current levels.

The FLRA budget request consists almost entirely of mandatory items of expenditure. As the table below indicates, salaries and benefits, space rental, and communications and utility charges constitute 90 percent of the FLRA appropriation request leaving little money in what is often referred to as discretionary items of expenditure.

ITEM	PERCENT OF TOTAL BUDGET REQUEST
Personnel Compensation and Benefits	76.0%
Standard Level User Charges	10.5%
Communications, Utilities, and other Rents	3.6%
All Other Categories	9.9%
TOTAL BUDGET REQUEST	100%

This budget request has been carefully scrutinized and represents only those expenditure levels necessary to accomplish our FY 1987 program goals. The agency is currently conducting an all encompassing review of resource utilization and procedures, to ensure that we are expending increasingly scarce resources in the most efficient manner possible to meet our labor relations mission. I have directed that all program and administrative functions be carefully examined to identify present and potential areas for resource consolidation, reduction or transfer. This review will be completed in March.

The FLRA was established to administer Title VII of the Civil Service Reform Act of 1978 and to serve as an adjudicatory agency in the resolution of labor-management disputes arising among unions, employees and Executive Department agencies (as well as some Legislative Branch agencies). The FLRA is also charged with resolution of labor-management disputes which may involve foreign national employees of the U.S. Government in the area of the Panama Canal, and our staff resources support the activities of the Foreign Service Labor Relations Board under Chapter 10 of the Foreign Service Act of 1980. There is a potential for labor-management disputes to arise in all these areas and the resolution of them by the FLRA contributes to the effective and efficient operations of the Government.

We are pleased to report that in FY 1985 the FLRA closed 822 cases marking the second consecutive year that record disposition levels occurred. More importantly, continued progress was made in reducing the number of aged cases on hand and in lowering the overall inventory of cases. The number of cases pending at the end of FY 1985 totaled 460. This represented a decrease of 277 cases or 37.6% in case inventory. In FY 1986 and 1987 we expect to further reduce year-end levels to 388 and 288 cases, respectively. Our goals will continue to be to provide the Federal labor-management community with timely and effective services while staying within anticipated constrained resource levels.

With these objectives in mind, I would like to review our major program units: the Authority Members, the Office of the General Counsel, the Office of Administrative Law Judges, the Federal Service Impasses Panel, and Management and Administrative Support.

The Authority Members program unit includes the Offices of the Members, the Offices of Chief Counsel, Case Management, and the Solicitor. This program unit is directly responsible for the processing of all cases within the jurisdiction of the Members, from the receipt of case filings and related documents through the issuance of decisions resolving disputes over arbitration awards, negotiability determinations, unfair labor practices, and representation issues. It also includes all activities relating to judicial review or enforcement of Authority decisions. (The Statute grants the Authority the right to be represented by its own attorneys in any civil action brought in connection with any function carried out by the Authority.)

Case intake in the Authority's four caseload areas is expected to remain relatively constant through FY 1987. During this period case closings will continue to exceed intake, thus reducing pending caseload. It is our goal to reduce turnaround time to the following levels; arbitration decisions will be issued within 5 months of filing, unfair labor practice decisions will be issued within 7 months of filing, and negotiability decisions will be issued within 11 months of filing. This output level will be achieved as a result of systemic improvements in case flow procedures, reduction in the number of levels of review, and the resolution by the Authority of precedential issues.

The Chairman of the FLRA serves also as Chairperson of the

Foreign Service Labor Relations Board, and the staff of the agency provides support to the Board. The Board, established in section 1006 of the Foreign Service Act of 1980, has jurisdiction over labor-management disputes involving Foreign Service employees and its functions include (1) supervising or conducting elections to determine whether a labor organization has been selected as an exclusive representative; (2) resolving complaints of alleged unfair labor practices; (3) resolving issues relating to the obligation to bargain in good faith; and (4) resolving disputes concerning the effect, interpretation, or claim of breach of a collective bargaining agreement.

The Office of the General Counsel has final authority over the investigation of charges and the issuance and prosecution of all ULP complaints. The Office also investigates and makes the initial disposition on representation petitions; supervises or conducts representation elections and certifies the results to the parties; and conducts hearings in representation cases. In addition, the General Counsel directs and supervises the activities of employees in the Regional Offices. General Counsel Miller, in his prepared statement, will address the program and the budgetary aspects of the General Counsel's operation in FY 1987.

The Office of Administrative Law Judges is charged with the responsibility of holding hearings on unfair labor practice complaints issued by the General Counsel and for recommending decisions to the Authority. It is projected that the number of ALJ settlements and decisions will total approximately 714 in FY 1987. Significant reductions are projected in the time from complaint to hearing and the time from hearing to the issuance of decisions in FY 1987.

The Federal Service Impasses Panel is an entity within the FLRA which is responsible for assisting Federal agencies and unions representing Federal employees in resolving impasses arising out of labor negotiations. It is composed of Chairman Roy M. Brewer of California and Members N. Victor Goodman of Ohio, Robert G. Howlett of Michigan, Daniel H. Kruger of Michigan, Susan S. Robfogel of New York, Thomas A. Farr of North Carolina, and Jean T. McKelvey of New York. All are Presidential appointees and serve on the Panel on a part-time basis. The Panel serves as the Federal sector substitute for the strike/lockout. It should be noted that the workload of the Panel, like that of the Authority, is uncontrollable. If the mediation efforts of the Federal Mediation and Conciliation Service (FMCS) prove unsuccessful, the Panel will then assist the parties, as required, in resolving the impasse. Resolution techniques utilized by the Panel include informal conferences, factfinding and interest arbitration. The Panel emphasizes voluntary settlement, believing that agreements which are reached by the parties themselves enhance commitments to contract terms. It is projected that in FY 1987 the Panel will resolve approximately 156 impasses. The Panel hopes to handle this caseload entirely through productivity improvements. The Panel is dedicated to furthering the principles of collective bargaining in the Federal sector and will continue to emphasize voluntary dispute resolution. In addition, the FSIP staff supports the Foreign Service Impasse Disputes Panel in resolving negotiation impasses arising under the Foreign Service Act of 1980.

The Management and Administrative Support function provides agency-wide support services to the National and Regional Offices. The Offices of the Executive Director/Administrator, Comptroller, and Personnel are responsible for the full range of budget, financial, personnel, data processing, and administrative support services. Of course, accomplishment of our mission depends to a great extent on the effective performance of these support functions.

In summary, I am pleased to report that the FLRA has made significant progress in the reduction of its case inventory and in providing the parties with timely responses to requests for decisions. I fully intend to continue these advances and simultaneously implement productivity enhancements designed to meet projected resource reductions. I am committed to the principle that it is our responsibility as Federal employees to efficiently and effectively utilize scarce resources to accomplish our mission at the least cost to the taxpayers. We will continue to seek out improved methods to accomplish this principle. To that end, I ask your approval of our budget request for $17,064,000 in FY 1987 to allow us to continue to meet our mission of promoting improved Federal labor relations.

I will be glad to answer any questions you may have.

STATEMENT OF JOHN C. MILLER

As the General Counsel of the Federal Labor Relations Authority, I appreciate the opportunity to appear before you to present the budget request for the Office of the General Counsel for fiscal year 1987 and to support the total budget request for the Agency. We have already submitted a detailed written budget justification in support of our request. With your permission, I would like to touch briefly on some of the highlights of that justification and make a few observations as well.

The budget request for the Office of the General Counsel for fiscal year 1987 provides for 145 full-time permanent positions and totals $7,656,000, excluding the costs of centrally funded items (GSA space, FTS communications, penalty mail, etc.). This request reflects a reduction of seven positions in fiscal year 1987, five percent below our approved staffing level in fiscal year 1986. Reflecting the impact of the Balanced Budget and Emergency Deficit Control Act of 1985, commonly referred to as "Gramm-Rudman", this request represents a reinstatement of the reduction of $384,000 from our final approved funding level for Fiscal Year 1986. At the same time, this amount is slightly below the funding level approved jointly by the House and Senate in H.J. RES. 465, making further continuing appropriations for the fiscal year 1986.

I wish to begin my statement by stressing my support for the President's budget submission. This is the third year in which I have testified before this Committee on the budget request for the Office of the General Counsel. The current budget request is the smallest that I have ever made for the Office of the General Counsel. When I first testified three years ago, I requested 169 positions for the Office of the General Counsel and $8,174,000. Today's request reflects reductions of 14% in staffing and 6.3% in funding over those three years. I am here to report that we have taken these reductions while improving both the timeliness of our case-processing activities and the high voluntary settlement rate which is essential to the success of our program. We have offset these reductions in resources only by increased productivity levels and with an increased settlement rate, because our caseload has remained relatively stable in the last three years.

As I said, I support this budget request and the President's initiative to reduce the level of government spending. This budget request reflects acceptance of an increased backlog in our workload. Thus, recent improvements made in the timeliness of our case processing activities will be affected. The staffing reductions of 22 positions over the past two years will be felt in 1987 and will primarily impact the unfair labor practice caseload. Backlogged cases and processing times could grow substantially over the next two years. I am hopeful that we can control these potential increases, and I will monitor them very closely.

The increase of $384,000 over our final funding level for fiscal year 1986, after the impact of "Gramm-Rudman," reflects the far-reaching impact of the reductions. This increase is required for the following:

the increased costs of personnel compensation required for career-ladder promotions and within-grade increases;

restoration of our training and development programs;

restoration of quality step increases, group awards, cash awards, and SES bonus payments;

restoration of our ability to fund permanent changes of station for our personnel, essential in a small agency when vacancies occur in key positions;

remove indirect restrictions for case-related travel;

restoration of funds to provide for the temporary reassignment of staff to assist in the elimination of temporary case backlogs;

provision for the payment of witness fees to Federal employees appearing in FLRA hearings;

rental of data-processing equipment to complete decentralization of automated case tracking system, and to provide capability for the Regions to query our automated case tracking system;

restoration of the full program to provide the clientele with printed materials and other information designed to enhance communications and contribute to the creation of a positive environment conducive to the voluntary settlement of cases;

provide for the potential increased cost of court reporting services necessitated by the rebidding of our contract;

restoration of funds to provide for payment of fees under the "Equal Access to Justice" Act; and restoration of funds to continue a program of purchasing rental equipment at prices most beneficial to the Federal government (which results in long-term savings to our agency and the Federal government in total).

The increases above are offset by the reduction of seven positions contained in this budget request.

In looking at our budget request, we continue to be a "labor-intensive" organization. Of our total request of $7,656,000, $6,605,000 (86.3%) is required for the costs of personnel compensation and benefits. A total of $575,000 is requested for travel, 7.5% of our total request. Court reporting services, maintenance contracts and other services will total $263,000, or 3.4% of our budget request. The costs for supplies and library subscriptions are projected to total $113,000, or 1.5% of our total request. The remaining 1.3% of our budget request, $100,000, is required for transportation of things, printing and reproduction of Agency materials, and the rental and purchase of needed equipment. In total, 94% of the budget for the Office of the General Counsel is allocated to the payment of staff and travel.

Nevertheless, in looking at this budget request, any further reductions to the President's budget will have some adverse impact on our operations.

I would like to briefly outline the responsibilities of the Office of the General Counsel. As an independent component of the Federal Labor Relations Authority, the General Counsel is directly responsible for investigating all alleged unfair labor practices filed pursuant to the Federal Service Labor-Management Relations Statute, the Panama Canal Act, and the foreign service labor-management relations provisions of the Foreign Service Act. Moreover, the General Counsel has direct authority and responsibility for the issuance of complaints resulting from the unfair labor practice charges filed pursuant to the aforementioned Statutes. The General Counsel also has responsibility for the investigation and disposition of representation case petitions, the conduct of all representation case hearings, the supervision of all representation elections, and the certification of the results of such elections.

Finally, the Office of the General Counsel is responsible for the supervision and management of the Regional Offices.

Experience in both public and private employment indicates that the statutory right of employees to organize, to bargain collectively through representatives of their own choosing and to participate in decisions which affect them, safeguards the public interest and contributes to the effective conduct of public business. These statutory protections also facilitate and encourage the amicable settlement of disputes between employees and their employers involving conditions of employment. The Federal Service Labor-Management Relations Statute details certain rights and obligations of the employees of the Federal government and establishes procedures which are designed to meet the special requirements and needs of the Government to be efficient and effective. The General Counsel operates in the Federal sector labor-management relations arena to ensure compliance with the statutory rights and the obligations of Federal employees, labor organizations which represent those employees, and the Federal agencies falling under the jurisdiction of Title VII of the Civil Service Reform Act of 1978.

With these thoughts in mind, I would like to express some of my specific observations regarding the preparation of this budget request. First, the Office of the General Counsel has no control over the size of its case intake. In fiscal year 1985 we experienced the third largest annual case intake in our history. Our actual case intake was within two percentage points of projected levels.

Second, in recent years we have taken several management initiatives which have contributed to the productivity increases seen in the processing of our caseload. Since our appearance before this Committee last year, we revised our procedures in the handling of deficient cases. In addition to being able to dispose of cases which were deficient on their face, roughly two percent of our intake during the trial period, the renewed emphasis on the sufficiency of charges resulted in more concise allegations, which reduced required investigatory time.

In fiscal year 1987 I will continue to assign the highest priority to the processing of representation cases, including the expeditious investigation of all petitions, conducting elections and hearings, and issuing final decisions in all cases involving hearings. This budget request provides the necessary resources for the timely processing of this priority workload -- a median time of 60 days from the receipt of a petition to disposition, roughly one month from the appropriate notice to either hearing or election, and roughly 90 days from the close of the hearing to decision. All projected timeframes are comparable to those being met currently.

In view of the high priority given to representation case processing, the impact of the reduction of the seven positions will be seen in delays in the investigation of unfair labor practice charges. Currently, initial dispositive actions in such cases are taken within approximately 60 days of filing (receipt of the charge). However, this time is projected to increase substantially. In addition, slight delays will be seen in the processing of complaints in charges determined to have merit. A total of 76 complaints will be in actual backlog status at the end of fiscal year 1987, the largest total since the end of fiscal year 1983. At the same time, the disposition of appeals in charges where the Regional Directors refused to issue complaint will be processed without delays.

With the above timeframes in mind, I would like to present a brief look at the case flow of the Office of the General Counsel, and to focus on the principal challenges in processing this caseload. When an unfair labor practice charge is filed, it is investigated and, if found to be meritorious, the parties are encouraged to settle voluntarily without further action. Roughly two-thirds of all charges found to have merit are settled prior to the issuance of complaint. When a complaint issues, settlement efforts are continued. The total settlement rate for our merit caseload was 93.5% in fiscal year 1985. Where settlement cannot be obtained prior to hearing, the complaints are prosecuted by the Office of the General Counsel in a hearing before an administrative law judge. Only six percent of all merit charges, as compared to only two percent of all charges received in the Regions, cannot be settled voluntarily and have to be referred to the Authority for final decision. In 1985, 5,349 cases were received and hearings were held in only 126 cases. In 14 other charges where voluntary settlement could not be obtained, the hearings were waived and the cases were stipulated directly to the Authority for decision.

Cases found to be without merit are either voluntarily withdrawn or are dismissed. It is projected that 55% of all cases determined to be without merit will be withdrawn. The remaining 45% will be dismissed and, of that number, approximately 35% will be appealed to the General Counsel.

Outlined below is a summary of the outcome of a percentage sample of 100 unfair labor practice charges, using actual experience from fiscal year 1985. The table summarizes all initial and secondary actions taken.

Merit cases	38			
Pre-complaint settlements		26		
Complaints		12		
Post-complaint settlements			9	
Hearings/stipulations to Authority			3	
Violation found				2
No violation found				1
Non-Merit Cases	62			
Withdrawals		34		
Dismissals		28		
No appeal filed			20	
Appeal filed			8	
Region sustained				8

Briefly, I would like to review our accomplishments in fiscal year 1985.

-- During the year, 5,696 cases were received. This total does not include 54 deficient cases which were not made sufficient prior to the end of the fiscal year. Intake in fiscal year 1985 exceeded the comparable total of a year ago by two percent, or 113 cases. Unfair labor practice charges totalled 5,349 cases, 94%, of the total intake.

-- A total of 5,781 dispositive actions were taken, slightly greater than intake during the fiscal year and 191 cases, 3.4%, above the comparable total for fiscal year 1984. Of this total, 71% were taken within 75 days of receipt,

and only four percent of all cases required more than four months from receipt of the case to dispositive action. Both percentage factors reflected improvement over comparable factors from the previous fiscal year.

-- Only 884 cases were pending without dispositive action at the end of the fiscal year. This total was the smallest ever for the Office of the General Counsel.

-- The median age factors were the best ever --

63 days for the unfair labor practice caseload;
49 days for representation petitions;
36 days for representation hearings, from the notice of hearing;
64 days for ULP complaints, from complaint to hearing; and
73 days for representation decisions, from the close of hearing.

-- The settlement rates were also the best ever --

pre-complaint settlement rate... 68.5%;
post-complaint settlement rate.. 80.0%, and
total settlement rate........... 93.5%.

-- Summary --

This concludes my formal statement in support of the President's budget request for the Office of the General Counsel for fiscal year 1987, except to note that the very high settlement rates combined with productivity increases by the staff were primarily responsible for maintaining timely case processing and controlling our case backlog. This budget is essential to our continued ability to perform our mission. With the continued support and assistance which this Subcommittee has provided in the past, I pledge that my staff and I will continue to strive to meet our responsibilities and the challenges ahead. Thank you for your attention. I will be happy to respond to any questions which you may have.

BIOGRAPHY OF JERRY L. CALHOUN

Jerry L. Calhoun assumed the duties as Chairman of the Federal Labor Relations Authority on December 16, 1985, after Presidential nomination and Senate confirmation. The Authority is an independent agency in the Executive Branch charged with providing leadership in establishing policies and guidance relating to the Federal Service Labor-Management Relations Statute. Additionally, the Authority plays an adjudicative role in the resolution of federal sector labor relations matters. As Chairman, Mr. Calhoun is the chief executive and administrative officer of the Federal Labor Relations Authority. In his capacity as Chairman of the Authority, Mr. Calhoun also serves as Chairperson of the Foreign Service Labor Relations Board which administers the conduct of elections and resolution of labor management disputes as they relate to foreign service personnel.

Prior to his appointment to the Authority, Mr. Calhoun was Principal Deputy Assistant Secretary of Defense for Manpower, Installations and Logistics. Following a major reorganization, Mr. Calhoun became the Acting Assistant Secretary of Defense for Force Management and Personnel (formerly Manpower, Installations and Logistics). His personnel and force management responsibilities included military and civilian personnel policy and management, labor-management relations, recruiting and training of active and Reserve forces, and mobilization planning. Additionally, he was responsible for various programs within the Defense Department involving energy, environment, safety, occupational health, equal opportunity and education of military and civilian dependents overseas as well as all logistics issues, including planning and construction of installation facilities worldwide. Prior to that assignment, Mr. Calhoun served as Deputy Assistant Secretary of Defense for Civilian Personnel Policy and Requirements, also with the Department of Defense.

Before his appointment to the Federal service, Mr. Calhoun was Manager of Industrial and Labor Relations with the Boeing Commercial Airplane Company in Seattle, Washington, where he held a variety of personnel management positions spanning a period of 14 years.

In addition to experience in private industry, he has taught on the faculty of the University of Washington School of Business in the areas of labor-management relations and human resource systems.

Mr. Calhoun was born in Ludlow, Mississippi on September 9, 1943. He graduated from Seattle University in 1967 with a B.A. degree in Political Science and Economics and received an M.A. degree from the University of Washington in Financial Management. Additionally, he has done post graduate work at Arizona State University School of Law and Public Administration, Stanford University School of Business Administration and the University of Michigan School of Business Administration.

BIOGRAPHY OF JACQUELINE R. BRADLEY

Jacqueline R. Bradley assumed the duties as the Federal Labor Relations Authority's Executive Director/Administrator on January 19, 1986.

As Executive Director/Administrator, Ms. Bradley manages the agency's administrative operations. She also directs the Authority's case adjudication process.

Prior to her appointment, Ms. Bradley served as a Special Assistant to the Acting Assistant Secretary of Defense (Force Management and Personnel), Department of Defense. She has also served with the Merit Systems Protection Board as Assistant Managing Director for Regional Operations, Regional Director - Denver Region, and Acting Regional Director - Seattle and New York Regions.

She graduated from Immaculata College (A.B. 1971) and Temple University School of Law (J.D. 1976).

HIGHLIGHTS OF BUDGET STATEMENT

Mr. MILLER. If I may, I will just take a couple of minutes and touch on a couple of brief highlights from it. Of course, I join Chairman Calhoun in saying that we support the President's budget. Certainly we are willing to accept whatever the committee decides is necessary to perform our particular function.

On behalf of the general counsel, for example, we are asking for 145 full-time, permanent positions and a total of $7,656,000. This excludes the cost of centrally funded items. I might say that this current budget request is the smallest I've ever made for the Office of the General Counsel. When I first testified 3 years ago I requested 169 positions and $8 million. Today's request reflects reductions of 14 percent in staffing and 6.3 in funding over those 3 years.

Also this budget, on behalf of the general counsel's side, at least, reflects our acceptance that we are going to have an increased backlog in processing cases, but not so high so that it is unacceptable. We will continue to monitor our caseload very closely and hope to keep it as timely as possible by more innovative approaches.

In terms of the budget request, again I must point out that we are a labor intensive organization, and of our total request of $7,656,000, 86 percent is for personnel compensation and benefits, and that finally 94 percent of our total budget is allocated to payment of staff and travel.

Senator ABDNOR. How much?

Mr. MILLER. Ninety-four percent. Moving on through my statement, the rest is rather routine. Getting over to page 8, I just wanted to give you a short picture of how we handled 100 charges. Of 100 charges we find that 38 had merit. We settled 35 of those. Three of those cases get to the Authority. Our settlement rate in the past year was 93.5 percent, which I think is very significant. We are trying to work with the Authority in decreasing some of their areas of backlog by limiting the number of cases that get there. And I think our settlement procedures have been among the best. That is the highest settlement rate we have ever had in the 3 years I have been here, 93.5 percent.

Other than that, I will certainly work with the committee in trying to monitor our costs and do the job with as much money as we get and prioritize our more urgent tasks.

IMPACT OF STAFF REDUCTION

Senator ABDNOR. You are going to have some backlog with that kind of a reduction. That 14 percent, that occurred just this year you say? I missed that—the 14 percent of the work force.

Mr. MILLER. The 14 percent is over 3 years, the 14 percent in staffing, yes.

Senator ABDNOR. Is this going to be a greater reduction than the other 2 years?

Mr. MILLER. Well, for this year we are taking a cut of 7 personnel, and last year we had 15. This year we are taking a cut of seven and the Authority is taking seven. That is being split between us.

Senator ABDNOR. What will that do to caseload?

Mr. MILLER. In responding, I would note that we have two major types of cases: Representation cases, which we give priority to; and then the second type of case is unfair labor practice. If the backlog does exist, it will be in the unfair labor practice area because it is more important to conduct elections and to make sure that the employees have a chance to choose or reject a union. Our objectives are to make a dispositive action in 75 days on unfair labor practices, in 60 days on representation cases.

We are achieving that in the main, but we expect that with these reductions of last year and this coming year that we will not be quite as timely and that there will be a little larger proportion of cases which will be overage.

Senator ABDNOR. How are you going to be affected, Mr. Calhoun?

Mr. CALHOUN. We will feel it; however, as I stated in my opening statement, sir, I believe that we can manage and it will not affect us in a major way insofar as our case inventory is concerned. We have had an inventory in the past, and our objective is to reduce that as we have over the last 2 years, and at this point I would certainly like to commend Mr. Frazier, who was Acting Chairman before my arrival. Under his chairmanship the last 2 years really were record years insofar as disposing of our inventory of backlog cases. I hope in the next year and the months to come that we are able to achieve similar results.

Senator ABDNOR. Both of you gentlemen have had to reduce each year for the last 3 years, and on top of that you have Gramm-Rudman-Hollings. What has that done?

Mr. CALHOUN. With regard to this first round of cuts, we have been able to absorb the reduction by not filling positions, by reducing travel, and basically within the Authority and all elements of the FLRA have saved—the general counsel can speak for his area, but we have basically spread that hurt, if you will, equally. And again as a result, we are able to meet our objectives by not filling vacancies and looking at our travel, reducing there, and looking at administrative overhead, and I think insofar as looking at those categories within our budget, we will be able to live under the current round of Gramm-Rudman. I cannot speak to the next round, August-October; that is going to be rather Draconian, I am sure, but we will certainly face that one.

Senator ABDNOR. We will see how this whole thing turns out. There is a lot of talk going around, and none of us know what it is going to mean.

If you do not mind, I would like to ask for the record that you give us a more detailed breakdown on the Gramm-Rudman effect on you. I commend you on your reduction. This time I said it right. How did that come about? How did you get that done?

[The information follows:]

IMPACT OF THE BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT OF 1985 ON FLRA

The FLRA's budget authority has been reduced by $734,000 for fiscal year 1986 as a result of the Balanced Budget and Emergency Deficit Control Act of 1985. To achieve this reduction the agency has implemented budget reductions across all programs and object classes. Only critical vacancies are being filled and those will be held vacant for longer periods of time in order to accrue savings. Agencywide reductions will occur in travel, training, printing, and reproduction. The elimination of overtime has also been implemented. FLRA expects to achieve this reduction without the need for adverse personnel actions, that is, reductions in force or furloughs. This is based on an assumed attrition rate consistent with historical levels.

STANDARD LEVEL USER CHARGE

Mr. CALHOUN. In our SLUC, the 10 percent, is that what you were referring to?

Senator ABDNOR. It has been reduced significantly. What is the reason? Have you reduced your need for space?

Mr. CALHOUN. Well, basically through regional offices, and we have closed the regional office in Hawaii. Jack's office did. Basically we turned back some space, and through those kinds of activities we have been able to turn back the 10 percent of the SLUC and we may be able to do a little better. However, the introduction of the new RENT system by GSA generated most of the decrease.

Senator ABDNOR. What has happened to your regional offices?

Mr. CALHOUN. Let me allow Jack to speak to that. The general counsel supervises the regional offices.

SPACE REDUCTIONS IN THE REGIONAL OFFICES

Mr. MILLER. We have at the present time nine regional offices and three subregions. We have one subregion in Cleveland which has two professionals and no clerical help at all. They work under the Chicago region. We did close about 3 or 4 months ago the Hawaiian subregional office because there wasn't a sufficient caseload there to warrant keeping a full-time professional and a part-time clerical. So we are saving roughly $66,000 including space, probably a little more than that when you count the space requirements and the individual who was there, because there is also a premium rate paid to Federal employees in Hawaii.

In regard to other regional offices, we review space requirements as these leases for space come up for renewal every 5 years, and within the last year we have had quite a few. San Francisco is up, I believe, in a couple of months. That is one of our most expensive regions and we are hoping that we can cut the cost. Every time a lease has come up we have tried to cut down on the amount of space and the cost, and I think we have been successful in the last couple of years. We have reduced approximately 10,000 square feet in the last 2 years.

It is fortunate that costs are going down in most metropolitan areas now for rental. And so overall we are achieving, I think, meaningful savings in rental costs.

DISTRIBUTION OF WORKLOAD

Senator ABDNOR. Out the number of cases filed, what percentage reach the authority?

Mr. CALHOUN. About one-third, I would say, if the cases.

Mr. MILLER. No; of the ones filed, that was the 100 charges that I mentioned and 38 had merit and 3 only. So in other words, out of 100 charges, 3 percent of them, 3 to 5 percent.

Ms. BRADLEY. Senator, but that is not the Authority's total caseload. Unfair labor practices are one of four types of cases that the Authority deals with. Some of the remaining cases come directly to the Authority, such as exceptions from arbitrators' rulings and negotiability appeals. So the 3 cases out of 100 that come from the general counsel is but part of our total workload.

Senator ABDNOR. What part would you say?

Ms. BRADLEY. I think about 30 percent of our workload is unfair labor practices cases.

Mr. MILLER. The Chairman's statement is correct when you consider the overall workload.

Senator ABDNOR. Are you staying constant, stable, or are you getting a workload increase in those other areas?

Mr. CALHOUN. We are projecting a fairly steady state of workload. We plan on probably about 535 cases in fiscal year 1987. And of those, the largest number would be in the negotiability area, then arbitration, then the unfair labor practice, and then the remaining would be in what we would call the miscellany of policy, rulemaking kinds of decisions that we would make.

We have over the last fiscal period closed 822 of the cases that have come into the Authority for disposition.

Senator ABDNOR. You have continued to reduce the number of pending cases at the end of each year. Is there any particular reason? Is this through harder work?

Mr. CALHOUN. I think a group of people have really decided to move cases. I think recently we have decided what we would call landmark decisions behind which were a number of what we called progeny or cases that were backed up awaiting a decision. And once those kinds of decisions are made, you can dispose of that universe of similar kinds of cases.

So we expect in this year to get our backlog down from about 516 as of this current month, hopefully down to close to 300 or even lower by the end of this year. I think we will be able to get at it fairly smartly, sir.

Senator ABDNOR. The budget anticipates a reduction in personnel for fiscal year 1987. Where will these cuts be made and what impact is it going to have?

Mr. CALHOUN. Well, we are an extremely labor-intensive enterprise, as you are aware. And it would be foolhardy for me to say that we could endure those kinds of cuts without affecting our people. I unfortunately do not feel comfortable speaking in the hypothetical and maybe some bolt of wisdom or bolt from the sky will turn all of these tides of gloom and doom around. The specter of Gramm-Rudman certainly does not give us warm feelings.

But to answer your question, sir, unfortunately we would have to obviously cut into some of the muscle of the organization if indeed worse case occurs August-October and that specter of 20 percent associated with the prospective Gramm-Rudman cuts becomes real.

Senator ABDNOR. Mr. Chairman, I am afraid that is also true in our workload with our section of the budget. What is happening to you is pretty common throughout the Government and we recognize that. We do not have many other programs to cut; we are talking about people. We know it is not pleasant or something you look forward to. You know, as you say, a bolt of lightening may come down on us. There is a lot of talk going around. I read the papers just like you do wondering what is going to happen.

On page 44 of your justification you indicate the average cost of a case is $1,206. Do you get nuisance cases and what is the cost of these?

COST FACTORS FOR CASE PROCESSING

Mr. MILLER. On page 44 is a listing of the cost factors for the general counsel, and in fiscal year 1986 you can see that the average cost is approximately $1,198. When we mean average cost, of course, some cases are immediately dismissed as not being covered. Some go fully through the litigation process and probably cost us $3,000 or $4,000.

So the average of that is approximately $1,100. It is only going up slightly in fiscal year 1987. And these are pretty much direct costs: the travel and transportation, a person's salary and benefits, and other direct costs.

Now, we had a new procedure inaugurated where we set up what we called deficient cases. When a case came in that alleged a violation and said the activity has refused to bargain with no details, we list that as a deficient charge, and then we require our reqional staff to contact the charging party and say we need more information. We need who, what, when, and where, and why and we are not going to investigate it until we get a vioable charge. So we list that as deficient. When they come back in with the proper material that makes the charge viable, then we go out.

Now, we had initially about 5 percent of the charges that are deficient and about 3 percent of those are remedied. And so as an end result about approximately 2 percent of the charges over the year are dismissed because they do not get back to us. They do not give us enough information. They do not—so we do not—we waste very little time with those. In fact, we do not even count those until they are made a viable charge.

ADDITIONAL COMMITTEE QUESTIONS

Senator **Abdnor**. I am sure we have other questions from both sides. The staff people and Senator DeConcini would likes to have been able to be here, but there is a debate up there on the floor and the subject is a very interesting one.

We thank you for coming and we know we have our difficulties in trying to put this budget together in our appropriations. I know you are concerned about what we do.

Thank you very much for being with us today. If we have any other questions, we will be back in contact with you. Feel free to call us. Thank you very much.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Additional Committee Questions

Question : The Budget request for the Office of the General Counsel for 1987 essentially equalled its request for 1986 prior to Gramm-Rudman. We noticed in the budget submission that GSA space costs were reduced by $112,000 from 1986 to 1987. Did the Office of the General Counsel share in any of these savings - or were all the savings derived from reductions in Authority space?

Answer (by Mr. Calhoun, Chairman): Space costs and other related fixed costs for items such as communications, utilities, postage, and health care services are centrally funded items. The FY 1987 projected reduction in space costs resulted in large part from lower rental rates evolving from GSA's implementation of the new RENT system. The introduction of the new RENT system will result in a one year dip in our per square foot costs. The introduction of the Rent System was incorporated in our FY 1987 Presentation to OMB last fall. Based on information from GSA we expect FY 1988 rates to rise by some 15% over the FY 1987 rates. Increases or decreases in these fixed cost areas are borne by the entire agency in its centrally funded program. Historically, repeated increases have occurred each year in most if not all centrally funded areas. These increases have been met by the agency without regard to which specific organizational unit incurred the increase. For example, in FY 1985 we received unexpected SLUC increases in several regions. Cost increases in excess of $100,000 associated with these rate changes were covered solely by the Authority since sufficient funds were not available at that time in the centrally funded area.

Finally, it should be noted that the consolidation of these fixed cost areas into one fund is consistent with the practice of other federal agencies and is in conformance with sound financial management practices. It is impractical in some instances to allocate these costs to individual components in any exact manner and unfair to managers to assign financial responsibility for costs over which they have little control.

Question : There appear to be conflicting figures in the budget submission we received this year with the one FLRA sent us last year. Last year's budget justification shows 80 positions under the section entitled "Authority Members." This year, the budget justification indicates that last year you had 84 positions under this heading, and in fiscal year 1987, will have 81 positions. Now, is this one more postion than you had last year or three less positions?

Answer (by Mr. Calhoun, Chairman): In last year's submission the Authority Members Program Unit included staffing from only part of the Office of the Solicitor. The remainder of that office (3 positions) was included in the Management and Administrative Support Unit. These three positions have been moved to the Authority Members Unit in this year's submission. Finally, one position originally located in the Office of Administrative Law Judges has been reallocated to the Authority Members Unit. Thus, the Authority Members Program Unit will in fact be reduced by 3 positions.

Question: I understand one section of a pending GAO report on the Federal Labor Relations Authority deals with the difficulties encountered by the General Counsel as an independent prosecutor when the FLRA Chairman controls the General Counsel's budget and personnel. Did the action the committee took last year in specifying dollar amounts and staffing levels for the Office of the General Counsel resolve these difficulties? Or will it be necessary for Congress to establish separate budget accounts for the Authority and the General Counsel?

Answer (by Mr. Calhoun, Chairman): There is no evidence that current or former General Counsels encountered any "difficulties" as a result of actions by any Chairman of the FLRA. I am unaware of any actions of previous Chairmen which interfered with the statutory responsibilities of the General Counsel and certainly, I will not take any such actions. Quite simply, there were no difficulties to be remedied by the Committee's action in specifying staffing and funding levels for the Office of the General Counsel.

The Committee's expressed purpose for including specific levels was concern about the General Counsel's "workload." Case statistics show that fewer unfair labor practice and representation cases were pending before the Office of the General Counsel at the end of FY 1985 than ever before in its history. Further, during FY 1985, the smallest number of representation elections were conducted in the history of the General Counsel. Case statistics also show that even with a 2 percent increase in intake from FY 1984 to FY 1985, total case intake has declined since the end of FY 1983. The General Counsel's workload does not justify concerns about its staffing and funding levels.

The issue of a separate budget for the Office of the General Counsel must be viewed in its statutory context. The FLRA has operated since its inception under a single budget which has been administratively controlled by the Authority. This operation was consistent with the Federal Service Labor-Management Relations Statute, which provides that any powers the General Counsel may have in addition to his statutory authorities to investigate and prosecute unfair labor practices and supervise employees in the Office of the General Counsel shall be only "as the Authority may prescribe." Unlike the Members of the National Labor Relations Board, who have delegated administrative control over the agency's budget to the NRLB's General Counsel, the Authority Members did not so delegate their authority. Since enactment of the Civil Service Miscellaneous Amendments Act of 1983, which made the Chairman the "chief executive and administrative officer of the Authority," the Chairman is solely responsible for the budget. This responsibility is consistent with Congressional intent to centralize administrative responsibilities for the entire agency in the Chairman.

In addition to our statutory authority, there are practical reasons for continuing the existing system. The FLRA is a small agency and all agency components, including the Office of the General Counsel, currently receive various administrative services from such Authority offices as the Solicitor, the Comptroller, and Personnel. The costs of providing those services, which are now absorbed by the Authority as part of its budget, would be included in a separate budget for the General Counsel. This would result in duplication of effort and expense. The estimated net cost increase in the first year, composed of five additional positions plus other miscellaneous expenses, would be approximately $240,000, with net increases of approximately $220,000 in succeeding years.

At a time when we are coping with significant resource reductions as well as anticipated future reductions, efficiency and economy of operations must be paramount. Providing the Office of the General Counsel with a separate budget would be counterproductive to efforts to reduce costs. The Office of Management and Budget concurs in our views on this matter.

The issue of a separate budget for the Office of the General Counsel has been an extremely divisive subject for this agency. As demonstrated, there is no objective support for a separate budget. Indeed, the existing scheme has worked well.

Question : Your request for FY 1987 does not include adjustment for the Gramm-Rudmann-Hollings sequestration. If that total was applied to your 1987 request, what would happen?

Answer (by Mr. Calhoun, Chairman): Imposition of a 4.3% reduction from our FY 1987 level will leave us at the exact operating level as this fiscal year. In light of recent budget reductions we are making decisions now with an eye to their impact on future costs. To that end all spending categories have been analyzed and we are in the process of devising alternative funding constraints. In addition, the current hiring freeze and future vacancies created will allow the agency to enter FY 1987 at a reasonable operating level. A reduction in budget to this year's level would restrict our operations but would certainly not be fatal to the Agency. However, I hasten to add that the $17,064,000 funding is a reasonable one which will allow us to have a positive impact on our government-wide labor relations mission.

Question : Would it be too much to assume that if you lived with the reduction in 1986, you could certainly utilize that level as a base in 1987?

Answer (by Mr. Calhoun, Chairman): I intend to search out all opportunities to streamline operations and contain costs at FLRA. As I have previously stated it would not be impossible to operate at this year's level. However, it should be noted that we have taken several short term actions to meet this year's reduction which could not be repeated without adversely impacting on our ability to meet goals I have established for response to our public.

Question : Have you reached the 135 square foot goal? If not, why and what is your target date?

Answer (by Mr. Calhoun, Chairman): The 135 square foot level is a government-wide goal. My understanding is that the GSA expects to achieve this level over a period of time. GSA, however, has acknowledged that while this is a goal it may not be achievable by every agency. FLRA, for its part, is working toward a reduction of its space. Over the past two and one-half years several regional offices have reduced their space and recently one sub-regional office was closed. These adjustments have resulted in approximately 13,000 square feet being turned back to GSA. This is equivalent to more than 12% of our FY 1984 inventory. We have submitted plans required by GSA reflecting future plans to reduce our space inventory to bring us in line with GSA's goal. Also, we are currently working with GSA to develop FLRA's supplemental space factor. This factor will provide for an amount of space \beyond regularly defined office space which is necessary to accomplish our mission. We do remain committed to and will implement changes which will reduce FLRA's inventory over the next few years.

Question : Cases from the General Counsel's activities make up a very small part of the Authority's case load. Would you detail what the other cases are?

Answer (by Mr. Calhoun, Chairman): Unfair labor practice cases reach the Authority in two ways: exceptions to a decision by an Administrative Law Judge or a stipulated record (where no hearing has been held before an ALJ). During FY 1985, ULP cases constituted 30% of our case receipts. Approximately 5% of the FLRA's case intake is composed of representation cases where a decision by a Regional Director has been appealed to the Authority. The remaining cases result from filings of (1) exceptions to arbitration awards (39% of FY 85 receipts), and (2) petitions for review of negotiability issues following agency assertions of nonnegotiability (26% of FY 85 receipts). A very small number of miscellaneous cases (requests for interpretations and guidance, Foreign Service Labor Relations Board cases) were filed during FY 1984 (3 cases) and FY 1985 (2 cases).

Mr. Calhoun, you are requesting an increase of $170,000 or 31% in travel and transportation of persons next year. This increase would bring this activity back to its pre-Gramm-Rudman level for fiscal year 1986. At the same time, your total number of permanent full time positions is dropping by 12 in FY 1987 to a new level that is 25 positions below fiscal 1985.

Q. In view of the fact that your staffing is dropping why should this Committee allow you to recoup your Gramm-Rudman losses and then some, for travel next year?

Q. What would be the specific damage that your agency would suffer if denied this large percentage jump for travel? Be specific.

Answer (by Mr. Calhoun, Chairman): The travel level contained in our 1987 request represents restoration of funds to our FY 1986 level. The vast majority of the increase (79%) is allocated to the Office of the General Counsel. Within the Authority the increase will be allocated to program travel on the part of the Administrative Law Judge's and the Federal Service Impasses Panel. Also during FY 1987, we expect to have the three Members offices filled. Travel by these offices is related to the processing of cases. Restrictions placed on their travel schedules would lengthen the time required to process cases.

You are asking for a hugh percentage increase for 'other services'. Your request of $547,000 in FY 1987 is 51% over your revised 1986 budget. A portion of this increase will be used for space renovations. And $108,000 of the increase over 1986 is due to an increase in cost of court reporting services necessitated by rebidding of your contract. (p. 33 of justifications).

Q. Can you tell us how much will you be spending for space renovations and provide details for the record? Then tell us why you are going to have to rebid your court reporting contract to the tune of $108,000 in additional expenses?

Answer (by Mr. Calhoun, Chairman): During FY 1987 the FLRA expects to spend approximately $10,000 for space renovations. These funds will be used to cover miscellaneous charges associated with implementing space reductions.

Question: The budget request for the Office of the General Counsel for 1987 essentially equalled its request for 1986 prior to Gramm-Rudman. We noticed in the budget submission that GSA space costs were reduced by $112,000 from 1986 to 1987. Did the Office of the General Counsel share in any of these savings--or were all the savings derived from reductions in Authority space?

Answer (by Mr. Miller, General Counsel): The Office of the General Counsel did not share in any portion of the $112,000 savings in GSA space rental costs. The budget request for the Federal Labor Relations Authority for Fiscal Year 1987 equalled the funding level for Fiscal Year 1986 contained in the continuing resolution which provided funds for the entire fiscal year (H.J. Res. 465). Although having the same level of funds and also having a savings of $112,000 in GSA space rental costs, the budget request for the Office of the General Counsel was reduced marginally and contained no share of the GSA space rental savings.

Prior to the submission of the Congressional budget, we prepared a written request to the Authority which asked specifically for information on GSA space rental costs for Fiscal Year 1987 for our Regional Offices. Our request for information was denied. We did not learn about the $112,000 savings in space rental costs until this Office received its copies of the final Congressional budget submission. We have yet to be provided with any information on GSA space rental costs for the Regional Offices for Fiscal Year 1987. It is our belief that the bulk (if not all) of the savings in GSA space rental costs was in the Regions, because of space reductions taken in the Regions during Fiscal Year 1985 and planned for Fiscal Year 1986.

The table below illustrates the allocation of the savings in GSA space rental costs (dollars in thousands).

	FY 1986	FY 1987	Difference
GSA Space Rental Costs (Total - FLRA)..	$ 1,901	$ 1,789	$ - 112
Office of the General Counsel	7,657	7,656	- 1
Authority	7,506	7,619	+ 113
Total FLRA FY 1987 Budget Request	$17,064	$17,064	No change

Question: I understand one section of a pending GAO report on the Federal Labor Relations Authority deals with the difficulties encountered by the General Counsel as an independent prosecutor when the FLRA Chairman controls the General Counsel's budget and personnel. Did the action the Committee took last year in specifying dollar amounts and staffing levels for the Office of the General Counsel resolve these difficulties? Or will it be necessary for Congress to establish separate budget accounts for the Authority and the General Counsel?

Answer (by Mr. Miller, General Counsel): The action which the Congress took to specify levels of funding for the Office of the General Counsel for Fiscal Year 1986 was of tremendous benefit. For the first time ever, the Office of the General Counsel could develop operating plans for a fiscal year with some assurance that the levels of available funds would remain constant. The advantages of the action by the Congress are reflected in the sustained timeliness of our case processing activities despite the impact of recent budget reductions.

Prior to Fiscal Year 1986, the Office of the General Counsel was vulnerable to unfair and inequitable budget reductions made arbitrarily by former Chairmen of the FLRA. The GAO report to which you referred cited four specific examples, among others, of the unfair and arbitrary cuts imposed upon the Office of the General Counsel. In its summary, while recognizing the improvements made under the current Continuing Resolution, the General Accounting Office concluded that the issue over control of funds for the Office of the General Counsel remained unclear. In its report, the General Accounting Office recommended that further steps be taken to clarify the issue, and commented that procedures at the Merit Systems Protection Board and the National Labor Relations Board could be used as models. Separate budget accounts for the Authority and for the Office of the General Counsel would resolve these difficulties.

Question: Is your workload in the Regional Offices relatively constant? Do they have typical workloads? In the justification you indicate targets for the number of cases to be settled and the time to do such? Are these realistic goals?

Answer (by Mr. Miller, General Counsel): The workload in the Regional Offices has remained relatively constant in the last three years, Fiscal Years 1983 through 1985, and we project that it will remain relatively stable in Fiscal Years 1986 and 1987. After fluctuating somewhat in the first three years of our existence, Fiscal Years 1980 through 1982, our intake has stablized. Our intake for the last three fiscal years is summarized below:

Fiscal Year 1983 . . . 5,710 new cases, an increase of 462 cases (8.8%)
Fiscal Year 1984 . . . 5,583 new cases, a decrease of 127 cases (2.2%)
Fiscal Year 1985 . . . 5,696 new cases, an increase of 112 cases (2.0%)

The intake for the Office of the General Counsel is divided between unfair labor practice (ULP) charges and representation (REP) petitions. Since Fiscal Year 1981, representation petitions have equalled between 6% and 8% of all new cases, and ULP charges have equalled between 92% and 94% of all new cases. Our experience is that the representation intake has stabilized at a level of roughly 375 new cases per year, while our ULP intake continues to fluctuate by roughly 100 cases on an annual basis.

Our ULP intake is divided into two types of cases--charges against Federal agencies and charges against labor organizations. The distribution of the total intake for the Office of the General Counsel has remained relatively stable. In addition, the percentage of total charges filed against Federal agencies has remained in a constant 94 to 96% range and the percentage of charges filed against labor organizations has also remained in the 4 to 6% range.

As you point out, the budget justification for the Office of the General Counsel does contain time targets for the processing of our caseload and goals for voluntary settlement. These goals are realistic and, in recent years, have been exceeded.

Our FY 1987 budget submission contains a goal of 65% for voluntary settlements prior to the issuance of complaint--voluntary settlement prior to the issuance of complaint in 65% of all cases determined to have merit. In

Fiscal Year 1985, our voluntary pre-complaint settlement rate was 68.5%, slightly higher than our target. The target for our post-complaint settlement is 75%--voluntary settlement in 75% of all charges determined to have merit where settlement could not be obtained prior to the issuance of complaints. In Fiscal Year 1985, this post-complaint settlement rate equalled 80%. Finally, the target for our total settlement rate is 91.5%--voluntary settlement in more than nine out of every ten cases determined to have merit. In Fiscal Year 1985, we reached a voluntary settlement rate of 93.7%. This factor was the highest ever for the Office of the General Counsel and I am committed to continue seeking a high percentage of the settlements. With the decreasing size of our staff, a high total settlement rate is essential to the timely processing of our caseload. We are proud of the fact that only about two ULP charges in every 100 received had to be transferred to the Authority for final decision. In all other cases, all actions (voluntary settlements, etc.) were taken within the control of the Office of the General Counsel.

Based on our experience, and given adequate staff and resources, it is our belief that the time targets and the goals for settlement contained in our budget justification are reasonable and obtainable.

Question: Your request for FY 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen?

Answer (by Mr. Miller, General Counsel): In essence, the increase of $384,000 requested for the Office of the General Counsel in Fiscal Year 1987 reflects the restoration of the Gramm-Rudman-Hollings sequestration. If the reduction of $384,000 were applied to our budget request for Fiscal Year 1987, we will have to continue many of the steps which we have implemented currently to reduce costs. Summarized below are the principal steps which we have taken to comply with the Gramm-Rudman-Hollings sequestration.

(a) Positions have been held vacant as turnover occurs. In some cases, positions will be held vacant through the remainder of the fiscal year. If the sequestration were applied to our budget request for Fiscal Year 1987, these positions would have to be held for a portion of 1987 as well.

(b) Currently, we have decreased the level of travel funds available to the Regions for the investigation of cases. These reductions have resulted in delays in case investigations and slight backlogs of cases in our more remote jurisdictions. If the sequestration is applied to 1987, then these delays will continue to develop.

(c) One of the major initiatives which we have undertaken is the increase in productivity. This initiative is consistent with a recent program of productivity increases announced by the President. Two of the major instruments in this program are incentive awards and staff training. During Fiscal Year 1986, we have suspended all incentive award programs and cut training funds by 50 percent. We are being pushed to increase productivity while having to eliminate the tools which we need to accomplish our goal. If our budget request for Fiscal Year 1987 is reduced, we will again be forced to reduce our levels of staff training and sharply curtail all incentive awards programs.

(d) As a result of the sequestration of funds in 1986, we have not been able to fund all PCS (permanent change of station) moves. Our ability to recruit the most qualified people to fill vacancies has been restricted by this action.

(e) One of my goals since I became General Counsel was to establish the policy that the Federal Labor Relations Authority would pay the costs of travel and per diem for its witnesses appearing at its hearings. Currently, even when witnesses are subpoenaed by my staff to testify in a hearing in a charge against a Federal agency, that Federal agency must bear the costs of travel and per diem. A situation is created where Federal agencies must pay witnesses in hearings where it is accused of having violated Federal law. If our funds are cut in 1987, then we would continue to have the situation where Federal agencies complain about paying travel for witnesses subpoenaed to testify against the Agency funding the travel.

(f) Prior to Fiscal Year 1986, funds were available to provide for temporary details of staff in instances where case intake increased sharply. Since the sequestration of funds, we have been unable to fund these temporary details and pockets of backlogs have developed. Continuing the restrictions on funding will be translated into increases in our case processing timeframes and decreases in our voluntary settlement rates.

(g) Under the current sequestration of funds, we have had to eliminate virtually all travel from our "National Office" to our Regional Offices. I have made no trips outside of Washington during this fiscal year. My Associate General Counsel has made only one trip outside of Washington thus far this fiscal year--a "day trip" to Philadelphia, Pennsylvania. We have three Assistant General Counsels who are directly responsible for supervising our Regional Offices. Two of these three individuals have taken no trips so far this fiscal year. The third Assistant General Counsel has visited three Regional Offices during this period. Our goal in the past has been to have each Regional Office visited once per quarter.

(h) In the last two years, we have been developing an automated case tracking system. At the present time, we are in a position where the automated system can be decentralized to our Regions. Input into the system can be delegated to our Regional Offices, and they will have a direct query capability into the system. Because of budget constraints, we have deferred full decentralization to Fiscal Year 1987. If the sequestration of funds is applied to 1987, then we will have to defer the decentralization for an even longer period of time.

Question: Would it be too much to assume that, if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

Answer (by Mr. Miller, General Counsel): With the caveats noted hereafter--yes, we could use the reduced level as a base in 1987.

As I have stated earlier, I support the President's budget request for Fiscal Year 1987. It is proper, I believe, to use the current appropriation in Fiscal Year 1986 as a basis for examining the budget request for Fiscal Year 1987. The increases requested in 1987 should be examined in light of operating experiences in 1986.

We are requesting an additional $135,000 in travel funds for five specific purposes--

(a) to provide funds to enable OGC Headquarters staff to travel to the Regional Offices for managerial and programmatic oversight (approximate cost of $20,000);

(b) to provide funds for temporary details of staff from one Region to another to alleviate temporary backlogs in case processing resulting from the loss of positions in the last two years (approximate cost of $25,000);

(c) to provide funds for the payment of Federal employees appearing as witnesses in FLRA hearings (approximate cost of $60,000);

(d) to provide funds for PCS moves (permanent changes of station) necessitated by the need to replace senior people who have resigned/retired (approximate cost of $20,000); and

(e) to restore a full level of travel funds to the Regions to complete required investigations in remote locations in a timely manner (approximate cost of $10,000).

The area of "Other Services" is the only remaining section of our budget request in which we have requested an increase of more than $20,000. This increase is based on five specific requirements--

(a) the increase in court reporting services necessitated by a rebidding of our existing contract (approximate cost of $60,000),

(b) to complete the decentralization of our automated case tracking system (approximate cost of $24,000);

(c) to restore funds to provide for payment of fees under provisions of the "Equal Access to Justice Act" (approximate cost of $10,000);

(d) to restore a full level of training for our staff (approximate cost of $10,000); and

(e) to fund increases in our existing maintenance contracts ($4,000).

In summary, we have used our 1986 level as a base for developing our 1987 budget request. We analyzed the areas where reductions were taken as a part of the Gramm-Rudman-Hollings sequestration, and we have justified the restoration of these cuts. As we have outlined previously, we can operate with the Gramm-Rudman-Hollings sequestration for the short term. For the long term, these reductions will have an adverse affect on the numbers of cases which we can investigate and on the timeliness of our case processing activities.

Question: Have you reached the 135 square foot goal? If not, why and what is your target date?

Answer (by Mr. Miller, General Counsel): The Office of the General Counsel has not yet reached the 135 square feet goal. Since March 1983 we have reduced space holdings by approximately 18% (roughly 12,500 square feet). Of that total, just under 12,000 square feet has been Regional Office reductions and approximately 600 square feet has been reduced in the National Office. The vast majority of the reductions have been in our Regional Offices due to losses in personnel. It is projected that by the end of Fiscal Year 1986, we will have an additional reduction of approximately 4200 square feet bringing our total reduction since March 1983 to about 16,700 square feet (24%).

Our overall utilization rate has and will continue to decline accordingly. We have advised the General Services Administration that we project meeting the goal of 135 square feet per employee by GSA's target date of the end of Fiscal Year 1989. This will require further reductions of approximately 10% each year for the ensuing Fiscal Years.

Since most of our reductions have occurred in Regional Offices, following is a chart depicting the reductions achieved and projected since March 1983:

DATE	TOTAL REGIONAL SPACE	REDUCTION	%
3/83	61,289 square feet	--	--
3/84	56,838 square feet	4,451 s/f	7.3%
3/85	52,090 square feet	4,748 s/f	8.4%
3/86	49,339 square feet	2,751 s/f	5.3%
10/86 (Projected)	45,122 square feet	4,217 s/f	8.5%
	TOTAL REGIONAL REDUCTION	16,167 s/f	26.4%

Mr. Calhoun, you are requesting an increase of $170,000 or 31% in travel and transportation of persons next year. This increase would bring this activity back to its pre-Gramm-Rudman level for fiscal year 1986. At the same time, your total number of permanent full time positions is dropping by 12 in FY 1987 to a new level that is 25 positions below fiscal year 1985.

Question: In view of the fact that your staffing is dropping, why should this Committee allow you to recoup your Gramm-Rudman losses and then some, for travel next year?

Answer (by Mr. Miller, General Counsel): Of the total increase of $170,000, $135,000 is requested for the Office of the General Counsel (OGC). In taking the reductions in travel to meet the budget cuts resulting from passage of the Gramm-Rudman Bill, we have taken every precaution to minimize the impact of the travel cuts on our Regional Offices. The restoration of $135,000 is not directly related to the reduction of seven positions in the Office of the General Counsel in Fiscal Year 1987. The total of $135,000 is required for the following purposes--

(a) to provide funds to enable OGC Headquarters staff to travel to the Regional Offices for managerial and programmatic oversight (approximate cost of $20,000);

(b) to provide funds for temporary details of staff from one Region to another to alleviate temporary backlogs in case processing resulting from the loss of positions in the last two years (approximate cost of $25,000);

(c) to provide funds for the payment of Federal employees appearing as our witnesses in FLRA hearings (approximate cost of $60,000);

(d) to provide funds for PCS moves (permanent changes of station) necessitated by the need to replace senior people who have resigned/retired (approximate cost of $20,000); and

(e) to restore a full level of travel funds to the Regions to complete required investigations in remote locations in a timely manner (approximate cost of $10,000).

Question: What would be the specific damage that your agency would suffer if we denied this large percentage jump in travel? Be specific.

Answer (by Mr. Miller, General Counsel): The easiest way to respond is to address each area where the reductions were made.

(a) A total of $20,000 is requested to enable management staff in our Headquarters Office to travel to our Regional Offices to conduct management reviews. Thus far this fiscal year, I have not traveled to any Region outside of Washington, D.C. The Associate General Counsel took one "day trip" to Philadelphia to our field office there. He has taken no other trips. We have three Assistant General Counsels for Field Operations who are directly responsible for supervising our Regional Offices. Two of these three individuals have taken no trips through the first five months of the fiscal year. The third Assistant General Counsel has visited three Regional Offices during this period. Our goal in the past has been to have each Regional Office visited once per quarter. Good management practices dictate constant communication between our Regional and Headquarters staff, and between our Headquarters staff and our clientele. In order to process our cases in as timely a manner as possible, we have sharply curtailed, and eliminated in some cases, Headquarters travel to our Regional Offices. We cannot continue this halt indefinitely, or management of our Regions will suffer. We believe that productivity will suffer, and that our standards in case processing will not be enforced adequately.

(b) A total of $25,000 is requested to provide for temporary details of staff in instances where case intake increases sharply. This year we have been unable to fund these temporary details, and the impact has been that pockets of backlogs have developed. The best way to avoid overwhelming backlogs is to stay ahead of them -- eliminate backlogs as soon as they appear. In the past we have been very successful in this area. This year, backlogs are beginning to develop, particularly in our San Francisco Region, which was without a Regional Attorney and without a supervisor for a prolonged period of time. Although we have now fully staffed the Region, a backlog of cases has accumulated which will take several months to eliminate. Our experience has shown that our settlement rate drops, and the costs of processing our cases increases, when backlogs develop. Continuing restrictions in funding for travel will be translated into increases in our case processing timeframes and into decreases in our voluntary settlement rates.

(c) One of my goals since I became General Counsel was to establish the policy that the Federal Labor Relations Authority would pay the costs of travel and per diem for its witnesses appearing at its hearings. Currently, even when witnesses are subpoenaed by my staff to testify in a hearing in a charge against a Federal agency, that Federal agency must bear the costs of travel and per diem. This situation creates a situation where Federal agencies must pay for witnesses in hearings where it is accused of having violated Federal law. The roles of witnesses are unclear when their travel and per diem costs are paid by one of the parties in a proceeding. If their fees were paid by my Office, then their role in the hearing would be uncompromised by financial considerations. This proposal would not cost the Federal Government any more money, because currently these fees are borne by other Federal agencies. If travel funds were cut, then we would continue to have the situation where Federal agencies complain about paying travel for witnesses subpoenaed to testify against the Agency funding the travel.

(d) A total of $20,000 is requested to provide for two PCS moves during the coming year. This year we have not been able to fund all PCS moves, and it has restricted our ability to recruit the most qualified people to fill our vacancies. Because we are such a small agency, we do not always have a pool of qualified individuals in every location to fill vacancies that occur. When we cannot fund PCS moves, some people are discouraged from applying for the job, and we are forced in some cases to select less qualified applicants. In this era when productivity increases are essential to the successful accomplishment of our mission, having to select a less qualified applicant would be counter-productive to our goal of efficient management

(e) A total of $10,000 is requested to restore a full level of travel to our Regional Offices. At the present time, travel to some of our remote locations has been delayed until a large pool of cases has accumulated in the particular location. Such actions have resulted in delaying the effectuation of the purposes of our Statute because investigations are not initiated in a timely manner. As outlined earlier, our experience has shown that our voluntary settlement rates decrease when investigations are not initiated promptly, because the positions of the parties harden and negotiated agreements become more difficult. When litigation results, rather than voluntary settlement, case processing costs increase. The additional $10,000 is a small price to pay for expedited handling of potentially disruptive labor-relations issues. This year we have seen increased backlogs in our European and Far Eastern jurisdictions. The position reductions which we are taking are being taken in conjunction with increases in our case processing timeframes. The impact of these reductions in conjunction with further cuts in our travel budget could extend the case investigation process even longer.

You are also asking for a huge increase for 'other services.' Your request of $547,000 in FY 1987 is 51% over your revised FY 1986 budget. A portion of this increase will be used for space renovations. And $108,000 of the increase over 1986 is due to an increase in cost of court reporting services necessitated by rebidding your contract (p. 33 of justifications).

Question: Can you tell us how much you will be spending for space renovations and provide details for the record? Then tell us why you are going to rebid your court reporting contract to the tune of $108,000 in additional expense.

Answer (by Mr. Miller, General Counsel): The OGC has no money budgeted for space renovations and our share of the increase you cite is $108,000. I want to begin by apologizing for the lack of clarity in our budget submission. The $108,000 increase in other services, which is shown on page 33 of our budget justification, is for five categories of expenditures--

(a) the increase in the cost of court reporting services necessitated by rebidding the contract ($60,000);

(b) to complete the decentralization of our automated case tracking system ($24,000);

(c) to restore funds to provide for payment of fees under provisions of the "Equal Access to Justice" Act ($10,000);

(d) to restore a full level of training ($10,000); and

(e) to fund increases in our existing maintenance contracts ($4,000).

We have had a lot of trouble with our court reporting service contract. When the contract was rebid last time, the low bidder obtained the bid by offering us a contract where the first copy of a transcript cost us only 9¢ per page, compared to $1.25 per page charged to the public. While the contract resulted in a savings to this Agency, it was very expensive to the public. We have had a lot of problems with our contractor, and service has been sub-standard in many areas. In rebidding the contract, we are specifying that the charge to public for copies of transcripts will be set at 95¢ per page. We expect that our costs will jump sharply under the new contract, with our costs per copy much closer to 95¢ per page than to 9¢ per page. It is for this reason that we project our cost of court reporting services to increase by $60,000.

Of our remaining increase of $48,000, $10,000 is set aside to cover potential costs arising under the "Equal Access to Justice Act". No funds have been set aside in Fiscal Year 1986 to cover potential awards under this Act. At the present time, however, two cases are pending before the Authority which involve such an award. Based on current experience, it is reasonable to assume that decisions will be issued in these cases during Fiscal Year 1987. In a recommended decision in one of the cases, an administrative law judge has recommended that the award be granted. The total of $10,000 has been set aside to cover this award.

A total of $24,000 is requested in Fiscal Year 1987 to complete the decentralization of our Regional automated case tracking system. This decentralization and expansion will provide the capability, in general, for our Regional Offices to use this system as a legal research tool--to query the system for the status and outcomes of cases involving certain issues. This decentralization effort has been deferred in Fiscal Year 1986 because of the Gramm-Rudman cuts. We believe that it will enhance productivity when completed, because legal research will be expedited. We have ten field office locations which would be connected to this decentralized system.

An increase of $10,000 is requested for training in Fiscal Year 1987. During the current fiscal year, we cut training funds by 50%, and we have denied training requests accordingly. Essentially, this level of training provides only two courses per Regional Office--not sufficient to meet our needs. Training is a critical part of our drive to improve productivity. With the emphasis on productivity increases in the coming year, restoration of this $10,000 in training is necessary.

Finally, an increase of $4,000 is requested to fund existing maintenance contracts on our data-processing and word-processing equipment. This increase is based on estimates provided by our vendors on projected costs in the upcoming fiscal year.

SUBCOMMITTEE RECESS

Senator ABDNOR. This does conclude our hearings today. We moved right along and I think we had some good hearings. I thank all our witnesses for testifying. You know we appreciate your participation. There is no further business to come before the subcommittee. We will stand in recess until tomorrow, Thursday, March 13, 2 p.m. At that time we will hear testimony from the departmental offices of the Department of the Treasury and the Internal Revenue Service. I am reminded the water bill is closer to coming up the way they are structuring it. I am the chairman of that committee. This committee may not be meeting tomorrow. We will have to keep everyone informed. Thank you very much. We stand in recess.

[Whereupon, at 4:30 p.m., Wednesday, March 12, the subcommittee was recessed, to reconvene at 2 p.m., Thursday, March 13.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

THURSDAY, MARCH 13, 1986

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–124, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor and DeConcini.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF PAUL H. COOKSEY, DEPUTY ASSISTANT SECRETARY FOR ADMINISTRATION

ACCOMPANIED BY:

JILL KENT, DEPUTY ASSISTANT SECRETARY FOR DEPARTMENTAL FINANCE AND PLANNING

ROGER COOPER, DEPUTY ASSISTANT SECRETARY FOR INFORMATION SYSTEMS

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order. Today we are having our second day of hearings on the 1987 budget review with testimony from several bureaus of the Department of the Treasury. We will review the submission of the Departmental Offices, the Financial Management Service, the U.S. Mint, the Bureau of the Public Debt, the U.S. Savings Bonds Division, and the Internal Revenue Service.

This is a pretty sizable schedule, I know, but we are trying to move through these quickly, and I am not going to take the time for an opening statement. Now if any of the members of the committee have any statements, we will place them in the record as though read.

Today our first witness will be Mr. Paul Cooksey, the Deputy Assistant Secretary for Administration. Paul, we welcome you to the committee. I understand you will present the testimony for the Departmental Offices, and then each of the bureau heads will follow.

INTRODUCTION OF ASSOCIATES

Mr. COOKSEY. Thank you, Mr. Chairman. It is a pleasure to be here this afternoon. I would like to introduce to you Ms. Jill Kent, who is the Deputy Assistant Secretary for Departmental Finance and Planning; and Roger Cooper, who is the Deputy Assistant Secretary for Information Systems, both from the Treasury Department.

OPENING STATEMENT

Senator ABDNOR. They can tell us all we want to know.

Mr. COOKSEY. Mr. Chairman, members of the committee, it is a pleasure to be here today to discuss the fiscal year 1987 budget request for the salaries and expenses appropriation. This appropriation provides funding for the Treasury's Departmental Offices, which support the Secretary and the senior officials of the Department in fulfilling their roles as policy advisors and managers of the activities of the Department.

These offices have broad and diverse functions, including: providing research and advice to U.S. domestic and international economic, monetary and tax policies; managing the fiscal operations of the U.S. Government and financing the public debt; overseeing Treasury's major law enforcement protective responsibilities; fulfilling international economic and financial responsibilities, as well as serving as the U.S. representative to various international financial organizations; providing management oversight of the operations including information systems of the Department's bureaus; serving as liaison with the public on issues of importance to Treasury; and discharging our obligation to properly maintain the Treasury buildings and grounds.

The fiscal year 1987 budget request reflects our commitment to fulfill these important responsibilities, and our recognition that limited resources are available in today's fiscal situation.

The Department's fiscal year 1987 budget request is for $80.1 million and 1,264 full-time permanent positions. This is an increase of $3.4 million over the level in the continuing resolution, or $6.7 million over the reduced Gramm-Rudman level. In addition, we are requesting that 19 full-time permanent positions be transferred from reimbursable to full-time permanent status.

The principal portion of this increase is an accounting adjustment that places on budget the administrative costs and staffing for the Federal Financing Bank in this appropriation. Previously the administrative costs of the Bank were handled off budget and the staffing was handled on a reimbursable basis.

The remaining increases are for the digital telephone switch, a major departmental initiative, costs to maintain the current levels of services in selected areas, and facilities maintenance improvements.

We are again requesting a merger of the salaries and expenses and international affairs appropriations in fiscal year 1987. As we have stated before, Departmental Offices is a single, integrated organization responsible for providing the Secretary with staff support in matters of policy analysis and coordination for the entire Department.

Merging the two appropriations will enable us to continue to provide the Congress with the same level of detail you are receiving now, and more, if you wish it.

I would like now to address each of our activities briefly. Of the amount requested, $21.2 million will support the secretarial policy and program development activity which encompasses the broad economic policy activities of Departmental Offices.

These include the development of tax initiatives, economic forecasts, fiscal policy, management of the public debt, and the oversight of our manufacturing process.

An estimated $4.8 million will support the inspector general function, which is responsible for developing and maintaining systems for audits and internal investigations of Treasury operations in Departmental Offices and nonenforcement bureaus.

The international affairs activity will require $13.1 million in fiscal year 1987. This activity includes a wide range of staff research and analysis functions dealing with international trade and investment, international monetary affairs, development financing, and general economic research into international financial issues.

An estimated $26.1 million is requested for departmental management and administration which is responsible for the general management and oversight of the Treasury bureaus and the administration of the Departmental Offices.

Approximately $12.2 million will be used to maintain, operate, and suuport the Main Treasury Building and Annex. Under the Federal Property and Administrative Services Act of 1949, the Treasury Department has operational responsibilities for the Treasury and Annex Buildings. Services that otherwise would be provided by the General Services Administration [GSA] are budgeted directly through the appropriation.

We are requesting a $434,000 program increase in order to maintain the building adequately. These increases include the following programs: to provide proper servicing of heating, ventilation, and air-conditioning system and the ongoing maintenance of the elevators; and to provide more comprehensive cleaning and janitorial service.

In addition, we are requesting $650,000 for necessary repairs and improvements to the Treasury Building and Annex. This is a decrease from the funds requested last year and will allow us to effect necessary changes to the Treasury's physical plant.

Mr. Chairman, this budget request supports our policy objectives, and will enable us to meet our responsibilities. Thank you for your consideration of our request, and I will be happy to answer your questions.

GRAMM-RUDMAN-HOLLINGS ACT

Senator ABDNOR. Thank you, Mr. Cooksey. We find that we are asking one question throughout our hearings. Tell us briefly how you handle the Gramm-Rudman-Hollings, the three words that seem to carry so much weight around here. I want a more detailed account in writing to us. But quickly, just tell us what it has done to you and how you have handled it.

Mr. COOKSEY. Mr. Chairman, we will be glad to submit a more detailed stamement on how the Gramm-Rudman reductions were taken in Departmental Offices for fiscal year 1986. We had a total cut of $3.299 million. The largest portion came out of personnel compensation and benefits, which was approximately $1.9 million.

We were able to make these reductions without a furlough, reduction in force [RIF], or freeze on hiring. They came mostly from a failure to utilize all the compensation we had planned to use in the first quarter. We plan to pick the rest of it up through attrition over the remainder of the fiscal year.

In addition, we made some reductions in travel, the equipment budget, and from the rent, communications, and utility budgets.

[The information follows:]

GRAMM-RUDMAN-HOLLINGS REDUCTIONS

To achieve the reductions required by Public Law 99-177, the Balanced Budget and Emergency Deficit Control Act of 1985, the $76,716,000 budget level passed by the fiscal year 1986 continuing resolution for Departmental Offices was reduced by $3,299,000.

The reductions in the fiscal year 1986 presentation submitted to the Congress will affect the following areas.

Full-time equivalent/positions.—The underutilization and/or nonfunding of at least 40 average positions in fiscal year 1986 including savings through attrition. This will restrict office operations and the Departmental Offices' ability to perform its responsibilities in such areas as tax and economic policy and domestic and international finance.

Summer hire program.—These reductions will require the scaling down or elimination of the summer hire program.

Travel.—The level of travel will be curtailed.

Representation.—Representation expenditures will be reduced.

Printing services.—Printing services and the purchase of supplies will be restricted.

Expenditures.—Expenditures for research contracts, building maintenance, rents and utilities, and other services will be reduced.

Equipment.—Expenditures for new automation and replacement equipment will be deferred.

FISCAL YEAR 1987 BUDGET PROPOSALS

Senator ABDNOR. Fine. Good luck. Legislation is being proposed to transfer the Small Business Administration loan portfolio to the Treasury. Now, what does this entail and how will it impact the Department. Also, if this legislation is not enacted, how is the budget request affected?

Let us start first with what this means to Treasury, and what is it going to involve?

Ms. KENT. Yes; our budget request includes $78 million and 1,664 FTE to take over the portfolio management and liquidation. That involves basically two functions. For the direct loans of approximately $7 billion, I believe, the Department will, over a 5-year period, manage and liquidate the portfolio. In addition, there will be loan guarantees to manage.

If the legislation is not enacted, of course, we will not need the request of $78 million for budget authority.

Senator ABDNOR. You are requesting funding totaling $2 million and 19 positions to administer Federal Financing Bank activities. Can you tell us the reasoning for requesting direct funding as opposed to the traditional reimbursable agreements?

Mr. COOKSEY. Yes, Mr. Chairman. As you probably are aware, the Federal Financing Bank was set up to coordinate federally assisted borrowing programs within the Federal Government to reduce the cost of such borrowing to assure that such borrowing is financed in the least disruptive manner in our private financial markets.

In the past, this activity has been funded off budget, and its administrative activities have been on a reimbursable basis. The Office of Management and Budget has recommended that this activity be made part of our appropriation, and in doing that, it would be necessary for us to request the $2 million for salaries and expenses and 19 full-time positions to fill that change.

Senator ABDNOR. When you add all those activities to you, it is going to mean more manpower all coming to Treasury. Will it mean moving? Everything will move into Treasury; right?

Mr. COOKSEY. Yes; including the $2 million which frankly would be meaningful to our budget.

Senator ABDNOR. I am sure that would have to be a part of it.

Mr. COOKSEY. Yes.

Senator ABDNOR. Now your budget proposes to eliminate nine positions in an effort to streamline operations. How are you going to do this, and what kind of positions are you going to eliminate? Is automation the backbone of it, or what?

Mr. COOKSEY. Of the nine positions, three can be eliminated within the domestic finance area. We feel that there are professionals who have been there to support the revenue sharing activities, and as revenue sharing winds down during fiscal year 1987, we will no longer need their support.

Of the remaining six positions, three are in international affairs and three are in the Inspector General's Office. We have found historically that both of these offices tend to lapse a number of positions each year, and we think this reduction is an economy we can take without affecting the performance of either of the offices.

As far as office automation affects this, I do not think these reductions are directly impacted by the improvements in office automation. However, I have some pretty strong feelings about that. I do think that office automation is a very good tool for both professional and secretarial efforts, and that as you improve office automation, you can certainly save in staffing.

MERGER OF APPROPRIATIONS

Senator ABDNOR. I have a number of questions. I will submit some in writing, but I want to ask you about this little matter. We have it every time. Once again the budget proposes to eliminate the "International affairs" account. The request indicates $13 million is necessary to fund this activity. The amount provided in fiscal year 1986 totaled $22 million. What do I assume? That the $9 million will still go toward international activities, and if so, what are those?

Mr. COOKSEY. Your question points out one of the confusing aspects of the budget for Departmental Offices. We have two appropriations: the salaries and expenses appropriation, and the international affairs appropriation. The international affairs appropriation, as you stated, is approximately $23 million.

The international affairs activity, which is specifically geared toward the international affairs activity of Departmental Offices, is for approximately $13.1 million. The difference between these two is essentially money and staff time that is used to support all of Departmental Offices. It is not just to support the international affairs functions.

We find that we take this $9 million and prorate it over all activities within the Treasury headquarters. This means prorating money for staffing, for purchasing personal computers, for rents, for utilities, and it has created a very confusing financial and administrative burden on us. We have requested a combination of the two appropriations so that we can manage Departmental Offices, the Treasury headquarters, as an integral unit rather than as two separate entities.

REPAIRS AND IMPROVEMENTS

Senator ABDNOR. We will take a look at it. One last question. You are asking for funding to address the asbestos and polychlorinated biphenyls [PCB] problem. Now will this completely take care of these problems at Treasury with no increase from last year? What repair work will be deferred as a result?

Mr. COOKSEY. I am very happy you raised this point, Mr. Chairman. In an old building like the Main Treasury Building and the Treasury Annex, we have found that with the older equipment and the older insulation systems we have both an asbestos problem and a PCB problem.

In our budget this year under the repairs and improvements request we have asked for $650,000, of which $550,000 is targeted for the replacement of six transformers that are old and really cannot be repaired properly. We do experience some PCB leakage from these transformers. We have been able to contain it very successfully, but all six transformers should be replaced. That will essentially take care of any serious PCB problem we may have in the immediate future.

As far as asbestos is concerned, we remove asbestos everytime we uncover it. And we have estimated this to cost between $50,000 and $70,000 a year. Recently, during the renovation of the Mint Museum space in the Treasury Building, we found that the entire ceiling was covered with asbestos. We had to pay about $20,000, as I recall, to have that removed in an approved, safe manner.

Whenever we uncover asbestos in the course of our renovation efforts, we will have it removed.

Senator ABDNOR. The money you use there will not have to be taken from something else?

Mr. COOKSEY. As long as you approve the appropriation for the amount that we have requested, we will be in pretty good shape.

Senator ABDNOR. You will be deferring repairing something else because of it?

Mr. COOKSEY. We have a fairly concise plan so that on any health threatening matter, we are not going to defer it. If it has to do with PCB's or asbestos, we are going to get the work done, and I do not think it will require the deferral of any other necessary maintenance or improvements.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Fine. We thank you folks for being with us, and as I say, we will be submitting questions in writing. I am sure Senator DeConcini will have some also. So you will be hearing from us.

Mr. COOKSEY. Thank you, Mr. Chairman.

Senator ABDNOR. Thank you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

ASSESSMENT OF CURRENT REPAIRS AND ALTERATIONS NEEDED

Question. GSA has indicated that deferred maintenance is a huge problem in the Federal building inventory. Treasury handles the Main Building and Annex. What is your assessment of current repairs and alterations needed? What would it cost? How long can we continue to defer these needs?

Answer. The Main Treasury Building was built between 1836 and 1869 and the Annex in 1919. These buildings have been in continuous use since their construction. The age of these buildings requires continual assessment and improvement to the building structures to meet minimal safety standards while maintaining the buildings' operation.

Under the Federal Property and Administrative Services Act of 1949 (as amended), the Treasury Department has operational responsibility for the Main Treasury and Annex Buildings. Services that otherwise would be provided by the General Services Administration are budgeted directly in Treasury's appropriation request. Two activities within the Departmental Offices appropriation (building maintenance, and repairs and improvements) are involved in handling the maintenance and repairs of the Main Treasury and Annex Buildings.

The building maintenance and operations activity is involved in the day-to-day maintenance and upkeep of the Treasury complex. The goal is to create a safe and hygienic work environment by providing adequate cleaning and janitorial services, and routine plastering and painting. Our fiscal year 1987 request includes an increase of $434,000 to support increases in our facilities maintenance contracts for the upkeep of the buildings. These projects include: maintenance and repairs to the heating ventilation and air-conditioning system; cleaning and janitorial services; and repairs to elevators. This workload cannot be deferred if we are to provide employees in the Main Treasury and Annex Buildings with a clean and safe work environment.

The other activity involved is the repairs and improvement activity which is responsible for major repairs and selected capital improvements to the Main Treasury and Annex Buildings. Large-scale necessary repairs are funded by this activity to ensure safe and habitable conditions for our public employees. Our fiscal year 1987 request includes a continuing level of $650,000 to provide repairs of a substantive, critical nature.

These repairs cannot be deferred without seriously endangering the safety and well-being of our employees. The funds would provide: (1) continuing removal of asbestos throughout the building; (2) replacement of six power transformers to eliminate PCB leaks and; (3) overhaul of our two main chillers due to a current, serious failure rate.

SPACE RENTAL COSTS

Question. Your SLUC rate is going up. Is that to be attributed to a new adjustment or requirement for more space? Are all of the people assigned to the Departmental Offices housed in the Main Building and/or Annex?

Answer. There are approximately 556 (both direct and reimbursably funded) Departmental Offices' employees who are located in rental space throughout the Washington, DC, metropolitan area. The remaining Departmental Offices' employees are located in the Main Treasury and Annex Buildings, which are owned and maintained by the Treasury.

All rental office space is provided by the General Services Administration, which negotiates the leases. The rental expenses set by the General Services Administration in fiscal year 1987 reflect an increase of $460,000 above fiscal year 1986 estimates. This increase is due principally to the fact that the rental rates per square foot are increasing. Rate increases have resulted from renewals of leases and proposed relocations of departmental offices' employees. These relocations will be required by the General Services Administration as old leases expire or consolidation efforts are made.

Additionally, rental space will continue to be required in several General Services Administration leased space locations until the Financial Management Service vacates the Treasury Annex and Departmental Offices is able to occupy this space.

TELECOMMUNICATIONS UPGRADE

Question. How close is the Department to completing its telecommunications upgrade program? Will future costs level off?

Answer. The Washington centrex replacement project is a departmental initiative to modernize Treasury telecommunications. This system will provide added voice communications capabilities and transmission network for data communications at a reduced cost and in a more efficient manner than the current centrex system. The Internal Revenue Service is the manager for this departmental program. A request for proposal to replace the current system was released in December 1985. Contract award is expected to occur by September 1986, with final system acceptance occurring by fiscal year 1988.

In fiscal year 1987, the Departmental Offices budget request includes an increase of $1,363,000 for its share of the system costs.

Contract performance will commence in fiscal year 1987, and costs will remain essentially at a constant level from fiscal year 1988 through fiscal year 1994. In fiscal year 1995 and beyond, costs will decline to include only operation and maintenance costs of the new system.

AUTOMATED INFORMATION SYSTEMS IMPLEMENTATION

Question. Automated data processing is critical in this era. The Department has made gains, but much more needs to be done. Could you briefly outline the needs and the plans to meet them?

Answer. There are three principal areas related to automated information systems implementation that I would like to address:

MAINFRAME REPLACEMENT

The current mainframe used in departmental offices is a Sperry 1100/82, which was acquired in 1980. This system is nearing the end of its system life; the hardware has reached its limit of expansion and is saturated by the growth in current and planned applications.

In 1985, Departmental Offices conducted a review of the information requirements to verify information needs and system development schedules. This review resulted in a revised information processing strategy encompassing the micro to mini to mainframe environment, in order to fulfill the requirements of Departmental Offices. An information systems' requirements analysis investigated alternative methods of meeting mainframe computer needs. The replacement system recommended by this requirements analysis will provide a sixfold increase in processing capabilities and will be able to meet response time requirements. The main core of the system is composed of two communications processors with increased tape and disk storage hardware. In addition, the system will allow the implementation of third-party software applications to meet user requirements.

A procurement action was initiated in fiscal year 1986 to replace the existing system, based on the changed requirements. The implementation of this program is scheduled to cover a 2-year period in fiscal year 1986 and fiscal year 1987. The first year program tasks include completion of the system acquisition and installation of computer system hardware and software. Second year tasks include conversion of current applications to the new environment and transition of users to the new computer system. During conversion, some applications will be redesigned to take advantage of fourth generation languages and end-user computing.

OFF-THE-SHELF SOFTWARE

New and enhanced systems will be implemented with off-the-shelf software to the maximum extent possible, in order to significantly reduce development costs. A new system to support budget, accounting, procurement, and property management in departmental offices will be implemented with off-the-shelf financial software, modified as needed to meet unique bureau needs.

OFFICE AUTOMATION

Staffing and budget limitations demand productivity increases from the current work force. One method of increasing productivity is expansion of office automation. Present office automation capability in Departmental Offices consists of work stations connected to three small VAX computers, stand-alone microcomputers, and word through automation, an increased number of work stations must be given the capability to exchange documents, additional easy-to-use software must be available and existing systems must be enhanced to meet user requirements. The ongoing mainframe replacement program will enhance the capability of the current office automation system and permit more communication between the individual work stations and with the mainframe.

THE 5-PERCENT TRANSFER AUTHORITY

Question. The Department is seeking transfer authority of 5 percent. Could you discuss this proposal?

Answer. Treasury's proposal for 5 percent transfer authority among all operating accounts within the Department is an initiative to improve financial management in a time of limited financial resources. This flexibility will allow Treasury management to meet emergency needs for unbudgeted requirements. An example of this transfer authority occurred last filing season when the Internal Revenue Service in an emergency situation transferred $72 million and 2,700 FTE from enforcement activities to taxpayer services in support of tax return processing.

This transfer authority is critical for the entire Department in order to balance workload requirements with limited resources.

FINANCIAL MANAGEMENT SERVICE

STATEMENTS OF:

GERALD MURPHY, FISCAL ASSISTANT SECRETARY

WILLIAM E. DOUGLAS, COMMISSIONER OF FINANCIAL MANAGEMENT SERVICE

ACCOMPANIED BY JILL KENT, DEPUTY ASSISTANT SECRETARY FOR DEPARTMENTAL FINANCE AND PLANNING

BUDGET REQUEST

Senator ABDNOR. Our next witness will be Mr. Gerald Murphy who is Fiscal Assistant Secretary, and Mr. William E. Douglas, who is Commissioner of the Financial Management Service [FMS].

Mr. DOUGLAS. Mr. Murphy was unable to be here this afternoon.

Senator ABDNOR. Fine. We will just turn it over to you and Ms. Kent.

Mr. DOUGLAS. Mr. Chairman, and members of the committee, the Financial Management Service has identified its resource requirements for fiscal year 1987 as $251,117,000 and 2,294 average positions. This request represents an increase of $6.5 million over our continuing resolution funding for fiscal year 1986, and $17 million over the Gramm-Rudman-Hollings funding level for the same year. Although this provides for no increase in average positions it will allow us to continue our systems modernization efforts and other improvements which, when complete, will generate many millions of dollars of savings to the Government.

PREPARED STATEMENTS

Mr. Chairman, in the interest of time, I would like to submit my general statement and that of Mr. Murphy for the record, and address any specific questions which you might have at this time.

[The statements follow:]

STATEMENT OF WILLIAM E. DOUGLAS

Mr. Chairman and members of the Committee, I am pleased to have this opportunity to present the Fiscal Year 1987 resource requirements of the Financial Management Service. I would also like to direct your attention to the part we play in assuring that American taxpayers receive an excellent return on their investment.

The cornerstone of the Financial Management Service is its mission "to promote the financial integrity of the United States Government through sound money management on behalf of the public". The key to accomplishing this mission is our ability to effectively manage the movement of Federal funds, and to make optimal use of Federal financial information. Service responsibilities stem from our obligation to the public, and our commitment to excellence on their behalf.

As manager of the majority of Federal cash movement, the Service controls more money than any organization in the world. We process $2 trillion in payments and collections annually. Producing and managing this huge volume of payments and collections requires approximately 87 percent of our total resources. Most of the remaining 13 percent is directed toward carrying out central accounting and reporting functions for the Government.

The Service is requesting $251,117,000 and 2,294 average positions for Fiscal Year 1987. This request represents an increase of $6.5 million over our Continuing Resolution funding for FY 1986, and $17 million over the Gramm-Rudman-Hollings funding level for FY 1986. Our resource request, which does not contain any increase in average positions, will allow us to continue our systems modernization efforts which, when complete, will generate significant savings to the Government.

The Service does not consider its appropriation request to be an expenditure but, rather, an investment with a high rate of return. Our efforts to improve cash and credit management techniques, as well as the development of more efficient payment and collection systems have been significant factors in reducing the Government's need to borrow money. In FY 1985 alone, these efforts eliminated $1.1 billion in interest payments in addition to $976 million interest earned from the Treasury Tax and Loan Investment Program. This was eight times more than our FY 1985 appropriation request of $246 million. Between FY 1986 and FY 1991 interest savings are expected to reach a cumulative total of $11.6 billion. In short, for every dollar appropriated to the Service in FY 1985, we return to the Government $8.00 in savings. In FY 1987, we expect total savings to be $2.1 billion. Interest earned from the Treasury Tax and Loan Investment Program will account for $781 million, and interest savings directly tied to Service efforts to more effectively manage the Government's money will increase from $1.1 billion to $1.3 billion.

In the last few years, the Service has undertaken many modernization efforts aimed at increasing the Service's use of automated and electronic systems to improve the Government's financial systems. The FY 1987 resource requirements include funds to continue these modernization efforts as well as undertake several new initiatives. These new efforts are designed to expand the use of automated technology while minimizing risks and vulnerabilities, emphasize cost efficiency while providing quality service to the public, and improve Federal financial management.

The Service's request is divided into six functional areas as well as an administrative function. The functional areas will be addressed in the following order: (1) Field Operations; (2) Headquarters Operations; (3) General Financial Services; (4) Federal Finance; (5) Reimbursement for Banking Services; and (6) Information Systems.

Field Operations

The Field Operations activity requires $134,433,000 and 916 average positions for FY 1987. This activity is by far the largest operating entity in the Service. Over half of the Service's resource requirements and 40 percent of its average positions are concentrated in the Field Operations area. Of considerable significance is the fact that 61 percent ($81 million) of the resources requested go to pay postage costs. The Financial Management Service will issue over 560,000,000 payments to Social Security, Supplemental Security Income, Veterans and recipients of other Government benefits in

FY 1987. These payments represent roughly three quarters of the 725,525,000 payments issued by the Service.

A significant aspect of Public Law 99-177 (The Gramm-Rudman-Hollings Act) is that it exempts from sequestering the benefit payments of a vast majority of our recipients. However, it does not protect the monies required to produce and mail these payments, nor does it make provisions for related payment processing costs such as handling of claims on lost or stolen checks.

As EFT payments continue to increase, and the Service moves closer to fully automated payment systems, the need for more comprehensive security measures becomes a pressing issue. Although the Financial Management Service has not suffered any financial loss from security breakdowns in our electronic payments systems (this is supported by audits and reviews), we have identified important vulnerabilities in our operations which must be fully addressed. We have undertaken efforts to correct the problems and have made considerable progress in reducing our vulnerability to potential loss, but additional action is required. We have subjected ourselves to a rigorous and fully objective assessment of our operations, and the Service is committed to correct all weaknesses identified.

The new paper check provides more than a dozen built-in security features designed to inhibit duplication, alteration and counterfeiting. All check payments in the Service's seven Regional Financial Centers are scheduled to be converted to the new paper check processing system by April, 1986. Non-Treasury disbursed checks will be fully converted by December, 1986. In addition to the enhanced security benefits, conversion to paper checks will save the American taxpayers approximately $6 million annually.

Headquarters Operations

The Headquarters Operations activity requires $23,714,000 and 582 average positions in FY 1987. This organization is responsible for important financial control and integrity activities related to the Federal payment and collection processes, including check reconciliation and claims activities. It adjudicates and settles claims resulting from lost, stolen, or destroyed Government checks. It collects monies from parties whose liability to the

United States results from improper negotiation of Government checks. Through the reconciliation process, $30 million in check payment overcharges and $56 million in bank reclamations are recovered annually on behalf of the Government. Moreover, millions of dollars of improperly classified collections are identified and properly credited.

The Service is substituting automated processes for its more paper-intensive functions wherever possible. We are replacing a 40 year old system to reconcile checks (600 million annually) with a modern, fully-automated one. The new system promises to be faster, much more reliable and capable of producing needed information.

General Financial Services

The General Financial Services activity requires $1,815,000 and 51 average positions in FY 1987. This activity provides financial services for approximately 100 trust and miscellaneous accounts, including the two Social Security Trust Funds, the two Medicare Trust Funds, the Unemployment Trust Fund, D.C. Government Loan accounts, the Synthetic Fuel Development Account, and the Airport and Airway Trust Fund. In addition, this activity provides for payment of domestic and international claims.

Federal Finance

The Federal Finance organization requires $15,533,000 and 338 average positions in FY 1987. This activity works with Federal program agencies to establish and manage efficient, cost effective cash and credit management programs and ensures the integrity of the Goverment's accounting, reporting, and other financial services. It provides assistance and technical support to all agencies which participate in the payments and collections processes, and to private sector users of Government financial information. Federal Finance develops, disseminates, and implements operating policies, regulations, and standards affecting all aspects of the Government's cash and credit management programs and its accounting, reporting, and financial management systems.

Cash and credit management and funds control functions account for substantial annual savings to the Government by reducing the cost of depositary services; minimizing the levels of cash held outside the Treasury; enhancing the daily utilization of funds, including the proper timing of disbursements; and accelerating the flow of receipts into the Treasury. Last year almost $2 trillion in cash flow was managed or influenced by this organization, and total savings from all sources exceeded $2 billion.

Reimbursement for Banking Service

Reimbursement for Banking Services requires $41,410,000 and one average position in FY 1987. This activity provides for fee payments to approximately 14,000 banks for maintenance of Treasury Tax and Loan accounts and Treasury General Account processing. Fee payments are made to banks for Federal Tax Deposits processed under the Treasury Tax and Loan Investment Program (total collections approximately $660 billion) and Treasury, in turn, earns interest (approximately $1 billion) on funds held on deposit.

Information Systems

The Information Systems activity is requesting $34,212,000 and 406 average positions in FY 1987. Information Systems has responsibility for overseeing the development, implementation, improvement, and operation of financial systems which support our payment and collection activities as well as make possible effective money management in the Federal Government. In addition, Information Systems offers assistance, as needed, to other projects requiring systems development. As part of this process, Information Systems supports a large number of developmental efforts which will enhance the collections, payments, accounting, reporting, and resources management functions. A major thrust of these developmental efforts is to ensure that the Service's systems are integrated to the maximum extent to cut costs, increase effectiveness and eliminate redundancy. Its efforts are a major reason the Service has been able to save the American tax payer billions of dollars over the past several years.

Mr. Chairman, as stated earlier, our FY 1987 budget increase is $6.5 million over our Continuing Resolution funding level for FY 1986 and $17 million over the Gramm-Rudman-Hollings funding level.

We are requesting this funding increase primarily to implement improvements and to continue developmental and systems design efforts. The total amount of program changes identified in our budget for FY 1987 is $12,448,000 and it supports the Service's goals of assuring the effective and efficient operation of Governmentwide money management and delivery systems.

For FY 1987 we have identified seven major initiatives:

1. Financial Asset Management Program

This effort will expand and enhance Government collections programs which involve managing the systems by which Government collections are made; setting policy on the collection of funds; and ensuring that agencies adhere to standards established by the Deficit Reduction Act of 1984. We estimate that this effort will save the Government $653 million in interest for the period FY 1987 through FY 1991 through improved financial asset management.

2. Accelerated Delivery Systems

FY 1987 funding will allow us to purchase optical character recognition (OCR) systems, which we currently lease, to read and process paper checks, payment vouchers and non-tape issues.

These funds will also be used to increase the use of Direct Deposit/Electronic Funds Transfer (DD/EFT) by fostering greater agency commitment and by simplifying the enrollment process for benefit payment recipients. When accomplished, this effort will reduce the Government's $81 million postage costs by significantly increasing DD/EFT enrollment. This project will contribute to a $3.2 million postage savings in FY 1987 due to a reduction in the volume of payments mailed. Administrative costs for the Social Security Administration and other program agencies will also be reduced as more recipients enroll in Direct Deposit.

3. Security/FMFIA

We are requesting funds to continue a Servicewide security program that will more effectively comply with the existing directives and security requirements issued by the National Security Agency, National Bureau of Standards and the Congress.

This effort will further ensure and guarantee that the Service will have the ability to continue vital functions under various hostile environments amd emergency conditions and, more importantly, to recover from such disruptive activities.

4. Quality Assurance Program

Funds are requested to implement a sound Quality Assurance Program which will ensure that automated systems are designed, implemented and maintained so that acceptable levels of accuracy, reliability and quality are "built-in" the systems rather than "added on." This effort will result in more efficient system designs resulting in less "debugging" during system testing and implementation phases. Beginning in FY 1988, it is projected that a budgetary savings of $685,000 per year will result from operational efficiencies stemming from a sound Quality Assurance program.

5. Financial Information Utilization

This project will support, monitor and implement improved central financial management reporting and analysis capabilities and establish a data base to provide more timely and accurate reporting on financial management activities. It will also establish sound financial management policies and allow proper evaluation of the Federal Reserve Banks' compliance with fiscal regulations.

6. Headquarters Consolidation - Phase II

Last year the Congress appropriated funds that permitted the Service to move a large part of its headquarters operations from various Washington, D.C. locations to the Prince Georges Plaza in Hyattsville, Maryland (Phase I).

In order to successfully complete Phase II of our consolidation effort (movement of 500 employees into the Liberty Loan Building in Washington, D.C.), funding is needed. The Service will be incurring moving expenses and additional costs above the very basic renovations to be paid by the General Services Administration. The Liberty Loan Building is an extremely old facility and many upgraded renovations will be required due to the obsolescent design of the building. In addition to these relocation and renovation expenses, the Treasury Financial Communications System Control Center site must be relocated out of the Treasury Annex into the Prince Georges Center. Preparation at the new site, as well as the physical move of hardware must be completed without disruption of service.

7. Human Resource Utilization

The Service must ensure that all employees are equipped to handle the expansion of services and workloads in an ever changing work environment. This effort will provide employees, through retraining, with the needed skills to do their jobs effectively and efficiently in an environment where the work methodology is changing dramatically. Our employees realize that their familiar ways of working are changing and they must learn new skills and methods. We believe that if the Service expects its employees to accept new challenges, it must assist in the upgrading of their skills.

Summary

The Government and the nation are at a financial crossroads. We must provide essential Government services while facing the responsibility and the task of reducing the Federal deficit through sound financial management.

The budget that we present to this Committee identifies our most pressing needs and requirements. We look upon our budget request of $251,117,000 and 2,294 average positions as an investment in sound financial management that will continue to yield growth and savings to the Treasury, the Government and the American people.

Mr. Chairman, your continuing confidence and support of our Service's programs are appreciated. I will be happy to answer any questions you may have.

STATEMENT OF GERALD MURPHY

Thank you, Mr. Chairman, I appreciate the opportunity to discuss the Fiscal Year 1987 resource requirements of the Financial Management Service.

The Service is continuing its efforts to fulfill its responsibilities as the Government's central financial manager. Toward this end the Service has undertaken many modernization efforts aimed at increasing the Government's use of automated and electronic systems to improve Federal Financial Management. The FY 1987 budget request includes funds to continue these modernization efforts as well as undertake several new initiatives. These efforts will yield savings of $1.3 billion in FY 1987. Interest earned from the Treasury Tax and Loan Program will account for another $781 million in savings -- establishing the Service as a major profit center generating far more revenue than it spends.

Of the amount requested in FY 1987, $9.9 million are necessary for the continuation of our modernization efforts -- including $4.4 million for financial operations, $3.4 million for financial information (consolidated financial information management), $1.7 million for financial management policy (business activities resembling those of a corporate comptroller), and $.4 million for resource management. Another $2.5 million will allow the Service to complete its headquarters consolidation project. Because many of our FY 1987 initiatives are related to other projects, planned and ongoing, failure to fund our FY 1987 budget would break the continuity of our efforts and jeopardize our ability to realize significant savings. To accomplish these goals, we have identified the FY 1987 resource requirements as $251,117,000 and 2,294 average positions.

That concludes my prepared statement on the Financial Management Service appropriation request. Mr. Chairman, I would now like to turn to Commissioner Douglas of the Financial Management Service.

GRAMM-RUDMAN-HOLLINGS REDUCTION

Senator ABDNOR. Thank you, Mr. Douglas. We appreciate that, and we can move right along. There are some questions in Financial Management Service we want to ask you. For instance, how is the FMS implementing the Gramm-Rudman-Hollings reductions? It is a question, in all fairness to you, that I have asked all the groups before us because it helps us in our future work. We would like to know how you are going to implement it. Is this going to impede any of your work that you are trying to do?

Mr. DOUGLAS. Yes, sir; the impact on us for fiscal year 1986 was approximately $10.5 million, Mr. Chairman. We have had to absorb that in a variety of ways. What makes it particularly painful for an organization like the Financial Management Service is that easily three-quarters of our budget, 75 percent at least, is fixed costs. As you know, we produce over 700 million payments each year to recipients of Government payments. We have a postage bill that is about $82 million, which we have to pay to deliver those checks.

We also manage the collection system for the Federal tax deposits, the Treasury tax and loan [TT&L] system, that brings in $650 billion to the Government each year. The cost of the fees to commercial banks to do that will be about $40 million in this budget. So, those are costs that we are obviously going to pay. If the Government is getting $650 billion of its revenues through the TT&L system, we are going to pay $40 million in order to make sure that that happens. So, we have a relatively small amount of leeway to apply a cut even one of the dimensions of $10.5 million. One step we have taken is to leave some of our positions vacant.

About 3 percent of our authorized positions will not be filled for the rest of this year. In addition, we have reduced the amount of money that we should pay to the Federal Reserve System. We have also deferred improvements, various systems changes that in the long run would save the Government many millions of dollars, but for now we have to cut back, postpone, and reschedule.

Senator ABDNOR. Good. We would ask you to go one step further and put it in writing.

Mr. DOUGLAS. Yes, sir; I can give you a more detailed explanation for the record.

[The information follows:]

IMPACT OF GRAMM-RUDMAN-HOLLINGS REDUCTIONS

The Gramm-Rudman-Hollings reduction of $10.5 million for fiscal year 1986 will affect the Service's programs as follows:

Financial operations	−$3,161,000
Federal finance	−661,000
Reimbursement for banking services	−3,157,000
Information systems	−3,540,000

These reductions will have the following impact on the services we provide:

- —Staffing reduction of 50 positions may delay the processing of Government claims and accounting transactions;

—Postponement of the claims application redesign project will delay development of compatible, standardized, and fully integrated software in the regional financial centers;
—Termination of the capacity planning analysis for the headquarter computers will delay redesign of applications and projection of future growth in system needs;
—Reductions in reimbursements to the Federal Reserve banks [FRB] may affect the Service's relationship with the banks and, therefore, the quality of FRB services;
—Development of vital data needed by Treasury, Office of Management and Budget, and Congressional Budget Office for financial decisionmaking will be delayed. This includes automated support for lead agency programs in cash and credit management, as well as Governmentwide financial systems and analysis methods;
—Delay in efforts to improve on the collection, delivery, and reporting tied to Governmentwide programs;
—Reduce resources devoted to compliance with OMB Circulars A-123 on internal control reviews, A-71 on computer risk analysis, and the Federal Managers' Financial Integrity Act.

REDUCING FEDERAL RESERVE BANK PAYMENT

Senator ABDNOR. You said something about reducing the payment to the Federal Reserve Bank. Is this going to affect any of the service relationships with the banks, maybe the quality of bank services? Can you tell us a little about that?

Mr. DOUGLAS. Yes, sir; we certainly hope that it does not have a major adverse impact. We are working very closely with them to try to minimize that impact.

ELECTRONIC TRANSFERS

Senator ABDNOR. Let us hope that it works out. I know it is a big part of our relationship. What is the status of efforts to encourage electronic transfers? Are you making any progress?

Mr. DOUGLAS. Yes, sir; we are making some substantial progress in that area. For fiscal year 1987, this budget year, we estimate that the total number of payments made through electronic funds transfer [EFT] will be approximately 270 million payments. Four years ago that number was under 200 million. So we have gained close to 100 million payments in approximately 4 years.

We are hoping to have, by 1990, at least 60 percent of all the payments made by the Government done through direct deposit. Right now that percentage is in the low forties, 42 or 43 percent.

MOVE TO PRINCE GEORGES PLAZA

Senator ABDNOR. How is that transfer to the Prince Georges Plaza coming? When do you think it is going to be completed?

Mr. DOUGLAS. We have already begun to move people into that building, Mr. Chairman. We planned a phased move over several months because as individual floors were ready for occupancy, we could move people in. We started in November. We have 500 to 600 people in there now. Over the next three weekends, we will be moving in another 300 or 350 people so we are very close to completing the move this month.

Senator ABDNOR. Are you quite satisfied with the way it is working out?

Mr. DOUGLAS. Yes, sir; the General Services Administration, under the leadership of Mr. Golden, has really done an excellent job of providing us with a quality workplace in that building.

PAPER CHECK CONVERSION

Senator ABDNOR. Good. What is the status of the paper check conversion program, and how long will it take to complete?

Mr. DOUGLAS. We are very close to the completion of that program, Mr. Chairman. In December, all Social Security payments made across the country were made by the new paper check. That was approximately 21 million payments by paper check on December 3.

Senator ABDNOR. What is the reaction of the public?

Mr. DOUGLAS. The reaction was excellent, Mr. Chairman. In fact, the Social Security Administration told us that they had fewer queries and complaints in December than they have in a normal month despite the fact that this was the major transition period. So it went exceptionally well.

FINANCIAL ASSET MANAGEMENT SAVINGS

Senator ABDNOR. Good. The budget requests increases for financial asset management of $1.2 million. Now, the return over 5 years will save a projected $653 million. Now, tell me how does that work.

Mr. DOUGLAS. Well, sir, there are a number of items that are involved in that. Primarily, those funds will allow us both the staffing and the support services so that we can do more in the area of cash management, debt collection, and credit management. There the total debt owed to the United States, both guaranteed and direct, is over $1 trillion.

With this money we will work with agencies to help them in their efforts with cash management where major improvements can be made. Last year we saved the taxpayers about $1.2 billion through various cash management techniques, and we believe that amount can be expanded sbstantially.

In addition, we would work with agencies in the debt collection area to make them more effective in their various endeavors. So there is a tremendous potential for improved financial management in Government, and I think certainly the emphasis that Gramm-Rudman-Hollings has put on reducing the deficit means that more and more agencies are looking very closely at means by which they can improve either cash management or credit management, and thus to save money for the taxpayer.

Senator ABDNOR. As years go by are we going to see more savings like this?

Mr. DOUGLAS. Yes, sir; we have projected that amount over a 5-year period, but we have other initiatives that will save even more money. In fact, when you asked me about some of the impact of Gramm-Rudman-Hollings for this year some of our financial improvement efforts had to be postponed, and that means some very large savings cannot be realized until much later.

DIRECT DEPOSIT

Senator ABDNOR. All right. Are agencies responding to efforts to encourage employees to use direct deposit and EFT, and are you getting good cooperation?

Mr. DOUGLAS. Yes, sir; we are, Mr. Chairman. Over 60 percent of all Government employees, at this time, are now receiving their pay through direct deposit. Approximately 3 years ago, that number was about 50 percent so we have had a significant increase over the last few years.

Senator ABDNOR. They are cooperating with the program.

Mr. DOUGLAS. They are cooperating. We also have proposed legislation which is up on the Hill for consideration by both the House and Senate that would mandate direct deposit for employees, salary for all existing Government employees who make more than $25,000 a year, and also it would phase in all new employees under direct deposit.

Senator ABDNOR. What kind of savings will we get out of it?

Mr. DOUGLAS. There are significant savings, but most of those savings are received by the agencies themselves. Although we in FMS save 23 cents for every EFT payment made, as opposed to mailing the check, since most of the salary checks are distributed in the agency workplace, the major savings accrue to the individual agencies and not to us. It is not a major benefit for us, but it is a major benefit if you look broadly across Government.

Senator ABDNOR. Do you have any figures or statistics by agency and the employer participation?

Mr. DOUGLAS. No, sir; I do not. We do not have those figures for all Government agencies. I might mention, however, that under the leadership of Assistant Secretary John Rogers, the Treasury Department has moved to make direct deposit salary a more attractive option to employees. There has been a very large increase in the Treasury Department's percentage of participation.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Good. Mr. Douglas, I have more questions, but to expedite things we will put them in writing if you do not mind. I might say with the case of the Bureau of Engraving and Printing, we are going to do likewise. We will submit them in writing.

Mr. DOUGLAS. We will be happy to respond, sir.

Senator ABDNOR. Thank you. Thank you for being with us.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

SPACE

Question. Your budget indicates a sizable increase in the cost of space. Could you outline the reason for this increase?

Answer. The increase in the cost of space that the Service will occupy in fiscal year 1987 after the completion of its headquarters consolidation is due to the increased rental costs and the additional rental space that the Service will occupy. The increase in rental costs is based on estimates we have received from the General Services Administration in accordance with their new rent system. When the Service relocates out of the rent free Treasury Annex, it will be occupying rental space in the Liberty Loan Building and the Prince Georges Center. As a result, the total rental space the Service will occupy after its headquarters consolidation will be greater than the rental space presently occupied.

SECURITY

Question. Security is a major concern, as you have pointed out in the justification. You are taking steps to secure current automated data processing operations. Do you have projections as to how long it will take to finish security procedures and the possible cost?

Answer. Security is a major concern for the Financial Management Service. We regularly assess the vulnerability of our operations under the Federal Managers' Financial Integrity Act of 1982, regular audits by the inspector general and General Accounting Office, and our own internal security compliance reviews. This is a continuing program and there is no end in sight. Changes in threats, facilities, technology, and the way we do business force us to adopt and implement new ways to secure the operations.

The Service's budgets for fiscal years 1986 and 1987 each contain requests well over $1 million in support of our security activities as mandated by the Federal Managers' Financial Integrity Act. Our commitment is to reduce the Service's vulnerability to fraud and abuse. We will annually request some level of funding for security and we will likely never be at a point where we can be complacent with our security. In a recent hearing before the House Committee on Government Operations we were asked the cost for installing a major new technology for improving security over payment authorization throughout Government. We priced this option which provides electronic certification and message authentication at $31 million. At that hearing, I provided the following statement:

The Treasury financial communications system [TFCS] is the U.S. Treasury Department's electronic funds transfer link between Federal agencies and the Federal Reserve Bank communications system (Fedwire). TFCS is used for large, nonrecurring payments. In addition, deposit information for large deposits electronically transferred to Treasury's account with the Federal Reserve banks is made available to agencies through TFCS. It is not used, however, for recurring payments such as Social Security benefits, veteran's benefits, and the like.

It is very important that the following facts be emphasized:

- —The TFCS control center is housed in the Treasury Annex vault, a highly secured facility, containing a sophisticated set of fire, security, and protective systems. Access is very restricted and the site offers a high degree of functionality and protection.
- —There is no evidence that security for the Treasury financial communications system has ever been breached during its 10 years of operation.
- —There is no evidence that anyone has improperly used the system to divert or steal any money from the Government. Not $1.
- —The GAO audit report, issued in September 1985, found no losses resulting from security breakdowns, but made 14 recommendations for improvement in systems operations.
- —We agree with all but two recommendations; have completed nine; and the remaining three which are mostly additional systems edits, are in progress.

Treasury's first formal look at electronic certification came as part of a payments mechanisms study, which the Financial Management Service conducted in 1982–83. The report recommended that FMS begin to look at electronic certification as a part of overall electronic funds transfer.

In August 1984, the Treasury Department issued a directive requiring all Federal funds transfers to be protected by message authentication under ANSI standard X9.9 by 1988. We then established an EFT task force with representatives from Treasury, GAO, and the National Bureau of Standards to determine criteria for approving vendor hardware systems for electronic certification and message authentication.

The status of Treasury's electronic certification project as of today is as follows:

—The EFT task force has completed criteria for electronic certification and message authentication. Certified devices should be available in the May/June 1986 timeframe.

—A contractor is currently developing a proposal for an electronic certification pilot between two accounting offices in Washington and the Washington Financial Center. Vendor payment records will be transmitted under message authentication with an electronic certification. The two-stage pilot could begin this fall if funding is available.

After the pilot, full implementation will depend on the development of a telecommunications network between 6,000 certifying officers at 900 locations nationwide and Treasury's seven regional financial centers. In addition, we must replace our 1960's and 1970's style computers with systems incorporating current technologies. We believe full implementation could occur within 2 years of network availability. A breakdown of estimated costs is submitted for the record.

I would like to conclude my statement by reemphasizing three points.

First, Treasury has had no security related losses in TFCS. Although a few cases of abuse have been documented in the check issue systems, considering that FMS issues some 500 million checks each year, the record has been exceptional.

Second, although no losses have been experienced in TFCS, we agree with the General Accounting Office that the growth of EFT brings with it the possibility of large dollar losses. We also agree that signature verification is obsolete in terms of both security and operational considerations.

Third, the investment to provide the needed computer support system as well as electronic certification integrated with message authentication in an overall electronic funds transfer system is substantial, but we believe that the investment is necessary.

U.S. MINT

STATEMENT OF DONNA POPE, DIRECTOR

BUDGET REQUEST

Senator ABDNOR. We will next hear from Donna Pope, the Director of the U.S. Mint. Nice to have you back, Ms. Pope.

Ms. POPE. Thank you. It is good to be here, Mr. Chairman.

Senator ABDNOR. As you can see, we are moving right along today. It will not be necessary to make your entire statement. I see it is not very long, but you go right ahead any way you care to.

Ms. POPE. Thank you, Mr. Chairman. I did try to shorten it as much as possible. I am pleased to be here today to discuss the U.S. Mint's 1987 budget request. The budget request for salaries and expenses is $47.8 million and 997 average positions. That is an increase of $3.3 million over the Gramm-Rudman-Hollings bill, and $1.3 million over the continuing resolution.

This budget request will allow the mint to produce 17.2 billion coins which is an increase of 2.6 billion coins over the 1986 projected production. That will satisfy a projected requirement of 17.2 billion coins in 1987. Our contribution to the Treasury for fiscal year 1987 is estimated to be $564 million, $544 million of which is seigniorage, or in other words, profit, on domestic coinage, and $20 million is from the sale of our annual numismatic items.

We are anticipating several improvements as a result of our research and development projects begun with funds provided in 1985 and 1986, and these improvements will increase productivity and efficiency.

As you well know, in May 1984, a construction contract in the amount of $10 million was awarded to Caddell Construction Co., for the planned improvements at the Denver Mint, and we expect to finally complete the construction in the summer of this year.

A little commercial for the mint—we are proud of our continuing numismatic success. In addition to the very profitable annual coin and medal programs, the mint has recently completed several programs. The Olympic Coin Program raised over $73 million for the two Olympic committees, and a bullion profit to the Government of over $127 million. The George Washington Coin Program raised a profit of $42 million, and the Gold Medallion Program made a profit of $691 million.

New programs this year are welcomed with equal expectations. The Statue of Liberty Program which began in the fall of 1985 is off to a good start with preissue sales of $98 million with surcharges of $24 million going toward the restoration of the Statue of Liberty and Ellis Island.

In the fall of this year, the mint will begin selling gold and silver bullion coins, under legislation recently authorized by Congress.

Mr. Chairman, this concludes my brief remarks. I would be happy to take questions.

Senator ABDNOR. Thank you, Ms. Pope. We do not have too many questions. You run a fine operation.

Ms. POPE. Thank you.

Senator ABDNOR. We are just as interested in what happens at the mint as we are in our other agencies. Tell us about Gramm-Rudman-Hollings and how you are affected by it.

Ms. POPE. The Gramm-Rudman-Hollings' reduction for the mint was $2 million. We have a slackening of coin demand. As a matter of fact, it is actually dropping from previous years and from our projections. We had already cut back coin production when the $2 million reduction came along. Most of that reduction was absorbed by our reducing coin production. About $1.6 million of the $2 million came from the fact that we were not going to produce as many coins.

The amount of $275,000 came from a project that we had anticipated starting for an A&E design for the unused space at the Philadelphia Mint. But since coin demand is not rising at the rate that we once anticipated, it is not necessary to get it started in 1986.

Senator ABDNOR. Why do you think the demand is not there, any big reason for it?

Ms. POPE. There are all kinds of explanations. We did award a contract to Data Resource Inc., [DRI] to take a look at the way we are forecasting our coin projections, and there are a number of theories. One is that the lowering of inflation under this administration had a great deal to do with it. Also, the fact that at one time we were in a penny shortage and then produced so many pennies. We put them out there to make sure that everybody was comfortable with the fact that they would have enough pennies, and those are now in circulation causing a drop now in the demand for pennies.

Most of the drop in demand is in pennies.

Senator ABDNOR. In pennies. It made up the largest percent of your volume, did it not?

Ms. POPE. Yes; that is correct.

In 1982 we were making pennies like crazy because there was a penny shortage and everybody was getting very concerned. In some areas of the country it was a serious situation. During 1982 the percentage of penny production was 80 percent. But it is now presently 74 percent of our production.

Interestingly enough, while it sounds like a lot of pennies, the percentage of pennies to the other coinage has remained fairly constant for the last 20 or 30 years. It has been about 74 percent of total production.

Senator ABDNOR. The units per thousand are projected to increase significantly. What is the reason for that?

Ms. POPE. Actually the unit cost is increasing somewhat based on a 4-percent inflation factor applied to the cost of metal. But the actual unit cost of manufacturing, we are very proud to say, is going down.

Senator ABDNOR. It is.

Ms. POPE. Yes.

Senator ABDNOR. Good. It fluctuates—your coins. Is it not true that you had fewer coins being produced in 1986 than you may be estimating in 1987? Or did you say you are changing that estimate of coins needed for 1987?

Ms. POPE. In 1986 we lowered our projections, and we will be producing fewer coins than we thought. At the moment, we are anticipating the demand for 1987 to be 17.2 billion coins, and we are planning on producing to demand of 17.2 billion coins.

Senator ABDNOR. I guess that is a foolish question, but what do you base that on? What do you see that makes you think you are going to need more coins?

Ms. POPE. Mr. Chairman, that is far from a foolish question. It is one that crops up constantly whenever I make presentations, and one that we took a very hard look at. In the past, the mint had based projections on a historical growth factor which amounted to about an 8-percent growth. The mint simply took the year before and added an 8-percent growth factor. That was holding pretty true for a long period of time. Around 1980 another look was taken at how the forecasting was done, and it was decided that it would be more accurate to use M–1 as the factor, and that forecast about a 5-percent growth each year. That worked for awhile, and then suddenly in 1983, the mint's forecasts were off greater than they ever had been in the past. That is the bad news. The good news is we were a lot closer than the estimates that the FRB was giving us; they were further off.

That is when we went to Data Resource Inc., to take a look at how we are forecasting demand, and they have given us a brand-new formula that takes into account changes in population, changes in the retail sales of nondurable goods, attrition, and changes in inflation.

This is the first budget to which we have applied some of DRI's information. We will see whether that is closer than what we have been doing.

Senator ABDNOR. Good luck.

Ms. POPE. Thank you.

Senator ABDNOR. I hope you hit upon a solution because it must be frustrating to figure out what to anticipate for the next year. You are asking for 37 new positions at the mint. Where will these personnel be assigned and could you explain the need?

Ms. POPE. The 37 positions are all directly attributable to the increase in coin production of 2.6 billion coins.

Senator ABDNOR. If you have too many coins this year, we will cut back next year. I mean if you have too many coins in 1987, it will be a whole new look in 1988.

Ms. POPE. If we see that the demand is not where we think it will be, we certainly will not produce that. And I should tell you that we would certainly lapse the money. We do not use it for other things.

Senator ABDNOR. Tell us about the need for construction request. Did you not just say that is one place you—or was that in the coins? I've forgotten. When we asked you about Gramm-Rudman, that was coins. But what about your construction needs?

Ms. POPE. The Denver construction is about to be completed, and when that is completed it will be a more efficient operation, more storage space, and good dock space.

Senator ABDNOR. Mrs. Hussey will be happy.

Ms. POPE. Yes; she is looking forward to that. You are absolutely right, Mr. Chairman. She is looking forward to the time when the construction will be finished.

Senator ABDNOR. They ought to have a grand opening.

Ms. POPE. She is pushing for that. Yes; she certainly is. When the construction is finished we will be constructing the automated material handling system, and while most of the money for it was previously appropriated, we do need the $694,000 estimated to finish the material handling system. That is what you see in our expansion and improvement budget.

Senator ABDNOR. Thank you both very much. We appreciate your being with us today. Thank you very much.

Ms. POPE. Thank you.

BUREAU OF THE PUBLIC DEBT

U.S. SAVINGS BONDS DIVISION

STATEMENTS OF:

W.M. GREGG, COMMISSIONER OF THE PUBLIC DEBT

KATHERINE D. ORTEGA, TREASURER OF THE UNITED STATES AND NATIONAL DIRECTOR, U.S. SAVINGS BONDS DIVISION

BUDGET REQUEST

Senator ABDNOR. Moving right along, we are going to call on Mr. W.M. Gregg, the Commissioner of the Public Debt; and Katherine Ortega, Treasurer of the U.S. Savings Bond Division. Good to see you both again, and we are looking forward to your statements.

Mr. Gregg, who kicks off here? Is it ladies first? I do not know. I will let you do it your way.

Mr. GREGG. I have been asked by Mrs. Ortega to start first, if that is all right with you, Mr. Chairman?

Senator ABDNOR. Fine.

Mr. GREGG. I have a very brief statement that I would like to read, with your permission.

Senator ABDNOR. Go right ahead.

Mr. GREGG. The fiscal year 1987 request for the Bureau of the Public Debt is $180,656,000. The Bureau is reflecting significant savings as a result of implementation of the move to full-book entry. The move to full-book entry provides improved service and reduces the risk of lost securities. Net cumulative savings over the 7-year phase-in period are anticipated to be $46 million.

This year's request includes resources to support a higher savings bond workload and funding for a new computer system. The new computer system will replace a technologically outdated system with one that will support the public debt activities for years to come. Funding for reimbursing the Federal Reserve banks will cover only a portion of the total costs the banks will incur. Proposed legislation is being drafted that will authorize charging fees to purchasers of marketable Treasury securities.

The fees collected will be utilized to offset Federal Reserve bank costs in lieu of reimbursements by the Bureau from appropriated funds. The details of the proposed legislation are not yet available.

This concludes my prepared statement on the Bureau of the Public Debt's appropriation request, Mr. Chairman. I will be glad to answer any questions you may have.

PREPARED STATEMENTS

Senator ABDNOR. Thank you, Mr. Gregg. We will call on Ms. Ortega first, if we can, and then we will fire questions at both of you. First, we will insert both of your prepared statements in the record.

[The statements follow:]

STATEMENT OF W.M. GREGG

INTRODUCTION

Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss with you our FY 1987 Appropriation Request for "Administering the Public Debt." The Appropriation provides funds for both the Bureau of the Public Debt and the U.S. Savings Bonds Division. The latter is a separate organization responsible for promoting the sale of savings bonds. The requirements of the Savings Bonds Division will be discussed separately.

The Bureau of the Public Debt is a service organization responsible for the administrative functions required to conduct Treasury's debt financing activities and accounting for the public debt. The Bureau maintains offices in Parkersburg, West Virginia and Washington, D.C.

FY 1987 APPROPRIATION REQUEST

The total Appropriation Request for "Administering the Public Debt" in FY 1987 is $198,814,000 million. This represents a net increase of $12 million over the amount available for FY 1986.

THE BUREAU OF THE PUBLIC DEBT

For fiscal year 1987 the Bureau of the Public Debt is requesting $180,656,000 and 1,980 average positions, an increase of $10,314,000 and a decrease of 137 average positions. The reduction in the number of average positions is the net of 13 additional average positions required for workloads in the marketable and savings bonds programs and reductions of 150 average positions saved through improved automated processing and other reductions.

The budget request includes $37,098,000 to reimburse the Federal Reserve Banks for the work they perform as fiscal agents of the Treasury. This amount is not equal to the anticipated operating costs of the Reserve Banks during fiscal year 1987. Proposed legislation is being drafted that will authorize the establishment of fees to be paid by purchasers of marketable Treasury securities. These fees would, evidently, be applicable to securities maintained in the commercial book-entry system and for securities maintained for individual investors in the Treasury system. The details of the proposed legislation are not firm at this time but the objective is to offset the costs now incurred by the Reserve Banks for their work on marketable and special Treasury securities. Because work has just begun on drafting the proposed legislation, I am unable to describe the amounts of the potential fees or the specific activities to which they may be applicable.

MARKETABLE PROGRAM

The Bureau of the Public Debt will implement the new automated book-entry system for all new issues of marketable notes and bonds in mid-1986. The new system which has been named TREASURY DIRECT is being designed and developed by the Federal Reserve Bank of Philadelphia under the control and direction of the Bureau.

TREASURY DIRECT is an integrated book-entry computer system to establish, maintain, and service accounts for investors in marketable Treasury securities. This system will enable the Bureau to provide maximum reinvestment opportunities, as well as prompt direct service to individual investors. The savings to be achieved through this initiative over a seven-year period is $46 million and approximately 388 average positions. Savings of $1,963,000 and 99 average positions are reflected in the 1987 Appropriation Request.

The Bureau is requesting a modest increase of $182,000 to fund a Federal Records Center contract for microfilming approximately 5,000 numerical ledgers currently stored at the Washington National Records Center. This contract is necessary to comply with a notice from the National Archives and Records Center requiring the Bureau to dispose of these stored records.

SAVINGS BOND PROGRAM

In past years I have discussed with you the positive public response to the variable rate savings bond introduced by Treasury in November 1982. The response to this initiative is still favorable. Savings bond sales are expected to be 82.8 million pieces in FY 1986, an increase of 13% over the initial FY 1986 estimate, and 90 million pieces in FY 1987.

Our appropriation request includes an increase of $4.5 million to manage these additional workloads. This increase has been minimized by productivity savings resulting from the use of optical character recognition/magnetic ink character recognition (OCR/MICR) electronic equipment for processing savings bond issues.

TECHNOLOGICAL IMPROVEMENTS

The Bureau is requesting $5 million to replace its existing mainframe computer. The current system has been installed since 1976 and has been upgraded several times. However, it uses outdated memory and processor technologies which do not provide the flexibility to meet the Bureau's future data processing, telecommunication, and management information needs.

The new equipment will support the redesign of Bureau applications which will improve accounting controls, increase security, raise the level of service, and provide more accurate and timely management information. Cost savings of $7.6 million are anticipated over the new system's six year life cycle.

CONCLUSION

Mr. Chairman, this concludes my prepared remarks. We will be glad to answer any questions that you and the members of your committee may have.

STATEMENT OF KATHERINE D. ORTEGA

Mr. Chairman and members of the Committee, I am pleased to be here today to present the fiscal year 1987 budget request for the United States Savings Bonds Division.

The U. S. Savings Bonds Division has the important mission of increasing the sale and retention of Savings Bonds. The Division provides a safe and effective savings program for millions of Americans; broadens public ownership of the national debt; and reduces the cost of debt financing.

Since its inception, the Savings Bonds Program has demonstrated its value to the government and the public. From 1941 to 1985, the public has purchased over $237 billion worth of Savings Bonds at issue price. For many wage earners it has been the primary method of saving, and for the government it has been a stable source of financing the public debt. Over 80 billion dollars of Savings Bonds are now held by the American public.

Savings Bonds are particularly important now, because they are the most cost effective way the Treasury has to finance the public debt. A recent Treasury study estimated that bonds are about a percentage point less costly than marketable debt of the same maturity. This translates into interest cost savings of $270 million in fiscal year 1985 based on the $5.03 billion sold last year.

The Savings Bonds Program is unique because part of its success is due to volunteer support. Active national and local volunteer committees perform vital and outstanding services to the Division in the fields of banking, media, labor and industry. The efforts of the field personnel are multiplied through the directed activities of our volunteers.

The Division commissioned independent research in 1985 to help it conduct operations more efficiently and identify markets with the greatest potential for cost-effective growth. As a result, the Division changed its sales promotion strategies and public service advertising program in 1985 and continues to adapt, placing increased emphasis on the fast-growing market for over-the-counter purchase of Savings Bonds.

More publications and broadcast stations increased their use of the public service advertising created by the agency during the 1985 campaign season. These advertising materials played a major role in increasing public awareness of the Savings

Bonds Program. Highly favorable news coverage has also been obtained through staff and volunteer efforts.

Through these efforts we have increased over-the-counter sales 87 percent during the first four months of fiscal 1986, compared to the already high level of early 1985. Payroll savings sales have grown as well, and total sales so far this year are up 42 percent over last year's. This growth has been accompanied by an increase in the average price of each bond sold, making Public Debt operations more cost-effective.

The improved marketing program contributed to the fiscal year 1985 dollar sales of $5.03 billion which were 29% higher than the fiscal year 1984 level and the highest since fiscal year 1979.

For the first time in the Program's 45-year history, the over-the-counter market accounted for more than 50 percent of dollar sales.

For fiscal year 1987, the Division is requesting 273 FTE positions and $18,158,000. This request is an increase of $1,670,000 from the authorized level of FY 1986 with no increase in FTE positions. This increase consists of $500,000 to develop and distribute new market-targeted consumer and news media information materials; $741,000 to maintain FY 1986 program levels; $569,000 to maintain current levels; offset by decreases of $140,000.

During fiscal 1987, the Division will devote most of its resources to increase public awareness to build both over-the-counter and payroll savings sales. Efforts will be concentrated on those accounts which offer the greatest sales potential in order to make the most cost effective use of existing staff and volunteer resources.

SUMMARY STATEMENT

Ms. ORTEGA. Thank you, Mr. Chairman. I am pleased to be here today to present the fiscal year 1987 budget request for the U.S. Savings Bond Division. The U.S. Savings Bond Division has the important mission of increasing the sale and retention of savings bonds. Savings bonds are particularly important now because they are the most cost-effective way the Treasury has to finance the public debt.

The more than $5 billion of series EE bonds sold last year saved the Treasury an estimated $270 million in fiscal year 1985 by replacing more costly market borrowing. The Division has reexamined its sales promotion strategies and now places increased emphasis on the fast-growing market for over-the-counter purchase of savings bonds. A new ad agency and news media program have been extremely effective.

Through these efforts we have increased over-the-counter sales 87 percent during the first 4 months of fiscal year 1986, compared to the already high level of early 1985. Total sales so far this year are up 42 percent over last year's.

The improved marketing program contributed to the fiscal year 1985 dollar sales of $5.03 billion, 29 percent higher than the fiscal year 1984 level, and the highest since 1979.

For fiscal year 1987, the Division is requesting 273 full-time equivalent [FTE] positions and $18,158,000. This request is an increase of $1,670,000 from the authorized level of fiscal year 1986 with no increase in FTE positions. This increase consists of $500,000 to develop and distribute new market-targeted consumer and news media information materials; $741,000 to maintain fiscal year 1986 program levels; $569,000 to maintain current levels; offset by decreases of $140,000.

During fiscal year 1987, the Division will devote most of its resources to increasing public awareness to build both over-the-counter and payroll savings sales. Advertising will continue to emphasize the financial benefits of savings bonds.

Mr. Chairman, this concludes my statement, and I will be happy to answer any questions.

FEDERAL RESERVE BANK REIMBURSEMENTS

Senator ABDNOR. Thank you, Ms. Ortega. First, the budget indicates that the Federal Reserve banks will not receive full reimbursement for services, and this could lead to a less effective work relationship. If this is the case, why has the Department chosen this course of action?

Mr. GREGG. The reductions in the budget requests for reimbursing the Federal Reserve banks are a result of reconsiderations of a great many facets of our operation having to do with the charging of fees and reimbursements as a concept. With the budget amount for 1987, we will have about $37 million for Federal Reserve bank reimbursements.

Under these circumstances what we will have to do is discuss the shortfall with the Federal Reserve officials and advise them of the extent to which we will be able to make reimbursements. Our relationship with the Federal Reserve banks for reimbursable fiscal agent activities is at an operating level.

The cooperation and the quality that have been involved in this operational linkage for over 65 years have always been extremely high, and this should be expected to continue.

Senator ABDNOR. That is fine, Mr. Gregg, but we are a little concerned about this decision not to pay the bank for its services. It might create problems with Government agencies fighting one another. You do not think this action is going to make problems for you? That is quite a percentage drop, and I am just wondering how they are going to do? Some of us in Postal Service revenue are talking about letting the first-class mailers pick up other things for the other mailers. That does not always go over. It sounds great and makes for a good way to save dollars, but it does not always produce the end results anticipated.

You do not think you are going to have any unusual problems with this?

Mr. GREGG. Mr. Chairman, I believe the basic relationship with the Federal Reserve banks, at this point, is strong enough to sustain cooperation and efficiency as we develop new arrangements to pay for these services.

FEDERAL RESERVE BANK REIMBURSEMENTS

Senator ABDNOR. I hope you are right, Mr. Gregg. In other words, you do not think it is going to get to the point where we might have to pass legislation to change the fee system or whatever it is?

Mr. GREGG. No; I have no thoughts on that matter, sir.

Senator ABDNOR. Do you care to answer that Ms. Kent?

Ms. KENT. I have a comment to make, yes. Currently, the administration is in the process of drafting legislation which will permit the imposition of user fees directly by the Federal Reserve banks to customers for certain transaction and account maintenance functions. This will affect the book-entry system as well as the Treasury direct system so the Federal Reserve will be recovering the cost of performing services directly from some of its customers.

Treasury will pay for other services, and then to the degree that there are still Federal Reserve costs that are uncompensated, they can reduce the balances they submit back to Treasury. So their costs will be covered. I am not disputing that there will be some adjustments and some impacts on the banks, but I do not believe there will be any lack of coverage of Federal costs.

Senator ABDNOR. A user fee is fine, but is that being passed on to those who are responsible for the difference?

Ms. KENT. Yes; it will only be passed on directly to those who benefit from the services.

REPLACEMENT COMPUTER

Senator ABDNOR. Fine. The budget is requesting $5 million to replace the mainframe computer. What is the estimated life cycle, and will this provide savings?

Mr. GREGG. The system that we are proposing to install will have an estimated life cycle of 6 years. During that 6-year period, we expect to save in the nature of $7.6 million. This will be in the form of personnel savings and various efficiencies in processing the work that we do.

SAVINGS BOND SALES

Senator ABDNOR. Let me ask Ms. Ortega. Savings bonds activity is on the rise; right?

Ms. ORTEGA. Yes, sir; they certainly are.

Senator ABDNOR. Is it going to continue?

Ms. ORTEGA. We expect them to continue, yes. We have had extremely favorable publicity in major publications. All three major networks have covered the Savings Bond Program this past year. Sales are steadily increasing.

Senator ABDNOR. I am glad. We have had efforts in the past to encourage the private sector to push the sale of savings bonds to employees. Is this continuing to be one of your major goals?

Ms. ORTEGA. It continues to be one of our major goals. In addition, however, because of the increase in sales of bonds through banks, we have placed greater emphasis on more promotion with the media and working directly with the banks.

Senator ABDNOR. The goal, I believe, in sales of bonds is $6 billion?

Ms. ORTEGA. Yes, Mr. Chairman; last year our sales were a little over $5 billion, so we feel that it is feasible that this year our sales could reach $6 billion.

Senator ABDNOR. That is good. More power to you. That is quite an increase. Five to six billion dollars is a sizable increase. We wish you well.

Ms. ORTEGA. Thank you.

Senator ABDNOR. If you get $6 billion in sales that reduces borrowing by what? $324 million?

Ms. ORTEGA. That would be the reduction in the borrowing costs because it is almost 1 percentage point more cost effective to use the savings bond route rather than going out in the open market. We estimate that it saves just in interest costs about $54 million on each $1 billion of sales.

Senator ABDNOR. That is good. Payroll saving contacts are going to be substantially reduced we are told. Now have they proven less successful than other efforts?

Ms. ORTEGA. Again, we feel that there is more growth potential in the over-the-counter market. By working more closely with the media and with the banks we can increase sales at a faster pace. We will continue to serve our payroll savings accounts.

ADDITIONAL COMMITTEE QUESTION

Senator ABDNOR. Good. I certainly will not argue that with you. You are doing a fine job and know where you are going. We thank you all for being with us today and we probably will have other questions to submit to you in writing. We thank you all three for being here.

Ms. ORTEGA. Thank you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTION

Question. Will legislation be necessary to require the fees the Department is urging the bank to utilize? If so, what happens if the bill is not passed? If the fees are not imposed, will the Congress be asked to provide additional funding to the Bureau? What happens if we don't?

Answer. Legislation will be proposed which will authorize Federal Reserve banks to charge and retain securities transaction fees to recover costs incurred in operating the commercial book-entry system and the new Treasury direct system for individual investors.

The President's budget requests funding to pay the Federal Reserve banks for these services, which are estimated to cost about $19.8 million. In that case the total amount appropriated will have to be $218.6 million rather than $198.8 million. Only under proposed legislation does the President's budget request elimination of the $19.8 million, since it would no longer be needed to reimburse the Federal Reserve banks.

INTERNAL REVENUE SERVICE

STATEMENTS OF:

JOHN F.W. ROGERS, ASSISTANT SECRETARY FOR MANAGEMENT, DEPARTMENT OF THE TREASURY

ROSCOE EGGER, COMMISSIONER, INTERNAL REVENUE SERVICE

ACCOMPANIED BY:

JAMES OWENS, DEPUTY COMMISSIONER

JEAN OWENS, DEPUTY CHIEF COUNSEL

PHIL COATES, ASSOCIATE COMMISSIONER FOR OPERATIONS

ED HEIRONIMUS, ASSOCIATE COMMISSIONER FOR DATA PROCESSING

NORM BOLZ, ASSOCIATE COMMISSIONER FOR POLICY AND MANAGEMENT

STEVE TAYLOR, FINANCE DIVISION DIRECTOR

OPENING STATEMENT

Senator ABDNOR. Now, our final witnesses for today. Mr. John F.W. Rogers, the Assistant Secretary for Management of the Department of the Treasury. And Roscoe Egger, Commissioner of the Internal Revenue Service [IRS].

This is Mr. Rogers first time before this committee in his capacity as an Assistant Secretary, and I want to wish you the very best in your new position. We have had you before us in another capacity, and I know we can count on your continuing working relationship. We have had a good one between our committee and your agency.

This is going to be Commissioner Egger's final appearance before the subcommittee in his current position. I am sure we will see you often, but I just wanted to take a minute, if I can, to thank you, Roscoe, for the fine job that you have done. I do not know if being the Commissioner for IRS is like being the Secretary of Agriculture. Neither one is a winning position for popularity, I know.

I know it has not been an easy task, and I know what you have had to put up with and what you have put into it. You have put a great deal. We have had some tough times, I know, even right here. I want to state for the record here and now that this country is losing a very dedicated public servant, and we thank you for what you have been doing.

You have probably done as much as any one person to bring the largest and sometimes the most unwieldy bureaucracy into the 20th century, and that has not been an easy job. So I want to thank you for that effort and wish you the very best in your future endeavors.

Gentlemen, I call on you to proceed. Mr. Rogers, go right ahead.

STATEMENT OF JOHN ROGERS

Mr. ROGERS. Thank you, Mr. Chairman. I am pleased to have the opportunity to discuss with you the President's fiscal year 1986 supplemental request and the fiscal year 1987 budget request for the Internal Revenue Service. Commissioner Egger is with me, and he will address the specific details of the IRS proposals. I am here to express the Department's support for the supplemental request of $340 million and 6,950 positions, and the fiscal year 1987 budget request of $4,098 million and the 95,084 positions.

The fiscal year 1986 supplemental addresses the Department's two primary tax administration concerns: restoring public confidence in the integrity of the system and strengthening compliance.

This Department's highest priority is restoring confidence in the system by ensuring the quality of tax processing. The experiences of the 1985 tax season were troubling to the Treasury and were a source of great frustration to the taxpaying public. It is my belief that a recurrence of the problems that plagued IRS last year would have a negative impact on the willingness of our citizens to comply with the system. Just a 1-percent drop in voluntary compliance results in revenue losses of almost $6 billion.

The Internal Revenue Service and Treasury have reviewed the total requirements for the Tax Processing and Taxpayer Service Program, and have developed a request which provides resources adequate for the Service to perform its responsibilities well.

The largest portion of this requested supplemental, $181 million, supports initiatives to make the current filing season successful. With these resources, IRS will: improve the quality of processing operations through increased management oversight and employee training; increase service center staffing to stay current with the workload; and expand taxpayer service levels to ensure that the IRS is responsive to taxpayer requests for information and account status.

The second major concern addressed by the supplemental focuses on enhancement of compliance and revenue collection activities. The tax enforcement initiatives in fiscal year 1986 which total $117 million include: increased emphasis on identifying cases of abusive tax shelters and currency transaction violations; advance hiring for a major revenue initiative to begin in fiscal year 1987 which will generate $10 billion in additional revenue through 1991; assistance to States in carrying out audits on foreign and domestic activities of multinational firms; and continued support of our enforcement functions.

The remainder of the increases in the supplemental are for required costs to maintain current staff, printing, postage, and space rental.

I cannot overstate the importance of timely consideration of the full amount of the supplemental. As for the fiscal year 1987 budget request for the IRS, we maintain the theme of the fiscal year 1986 supplemental: restoration of public confidence and strengthening of compliance efforts. This will be achieved in two ways.

First, IRS will maintain efforts initiated in fiscal year 1986 to rebuild the tax processing system and to be responsive to taxpayers. Second, it will increase emphasis placed on enforcement.

In addition, the budget provides for continued investments begun in early years to modernize IRS operations with state-of-the-art technology.

More specifically, the request maintains funding included in the supplemental for tax processing and taxpayer service activities, and provides $11 million to meet the expected growth in the taxpaying population.

With the fiscal year 1987 request, we intend to build a stronger and more credible deterrent against noncompliance with tax laws. In fiscal year 1985, IRS faced an estimated tax gap, taxes owed but not paid, of over $100 billion. This gap has risen from $29 billion in 1973 when the IRS first began estimating it.

This continued erosion of our receipts base through noncompliance undermines the confidence of the taxpayer and needlessly adds to the budget deficit. Accordingly, the fiscal year 1987 budget includes $136 million to strengthen compliance activities.

A major revenue initiative is the cornerstone of the budget. The proposal calls for annual increments of 2,500 examination staff for 3 years beginning in fiscal year 1987. This will result in an estimated $10 billion in additional revenue between fiscal year 1987 and fiscal year 1991 at a cost of $1.3 billion.

The IRS budget includes increases in other high revenue yielding activities: accelerated litigation of pending tax shelter cases and resolution of unreported income cases disclosed through the Document Matching Program. These increases will permit the IRS to make proper use of the numerous reporting documents that recent legislation requires taxpayers to submit.

The request also includes an increase of $52 million for automated systems initiatives. This reflects the Department's view that the integrity of the system demands investments that will increase effectiveness over the long term as well as the budget year. The additional resources will continue critical modernization efforts in Tax Processing and Tax Enforcement Programs.

The major project in this area, automation of the examination activity, will streamline the audit function through the use of automated equipment, resulting in a productivity increase of over 20 percent and an estimated increase in revenue collection of over $5.1 billion through fiscal year 1991.

The remainder of the increases are for required costs to maintain current staff, primarily due to price increases. In conclusion, the request for fiscal year 1986 and fiscal year 1987 provide the necessary resources to restore public confidence in the system, to strengthen compliance efforts and to continue our modernization efforts.

Mr. Chairman, I urge favorable consideration of the requested resources and must underscore the importance of timely consideration of the fiscal year 1986 supplemental. After the Commissioner presents the specifics of the request we will both be glad to answer your questions.

Senator ABDNOR. Before we get to the Commissioner, the increase of dollars and numbers, is that going to be based on the assumption that we are going to increase the 1986 in the supplemental, and will this be an addition based on that? Though we say 20 percent more, is it 20 percent more on not only what you have now but what else we hire in 1986? That is what we are basing 1987 on; right?

Mr. ROGERS. That is correct. Our 1987 request includes receiving the full supplemental of $340 million, sir.

Senator ABDNOR. All right. Let us go on to the Commissioner.

STATEMENT OF ROSCOE EGGER

Mr. EGGER. Mr. Chairman and members of the subcommittee, I am pleased to be here today to present our proposed supplemental for fiscal year 1986 for the Internal Revenue Service. But first I would like to introduce my associates from the Revenue Service that are here with me today: Deputy Commissioner, James Owens; Deputy Chief Counsel, Jean Owens; Associate Commissioner for Operations, Phil Coates; Associate Commissioner for Data Processing, Ed Heironimus; Associate Commissioner for Policy and Management, Norman Bolz; and our Finance Division Director, Steve Taylor.

Mr. Chairman, as you have already noted, I am making my final appearance before this committee, and during my 5 years as Commissioner I have enjoyed working with the committee. I appreciate the attention and the support you have given to our operations and budget needs, and needless to say, I rge your continued support for this year.

STATUS OF TAX ADMINISTRATION

When I became the Commissioner, I had no illusions about what I was getting into. I learned from my years as a practicing professional in the private sector that the IRS is a large and complex organization. One of my basic objectives as Commissioner has been to lay the groundwork for the IRS to enter the 21st century in the use of information technology.

My dedication to the place of information technology in tax administration is even stronger today than the day I came to the IRS.

The computer problems we had last filing system were serious. There is no question about it. But we have learned a great deal about managing massive system conversions, and we have learned from our mistakes. So, too, we believe that others will benefit from our experiences, but with it all, our commitment to continue modernizing and improve the Service operations remains.

We do not, certainly, intend to let last year's experience repeat itself, and quite frankly, we believe the Service will be stronger and better in the future as a result of the lessons we have learned. Our path to restoring effectiveness in tax processing can best be described in three simple words: back to basics.

The back-to-basics theme will be carried throughout IRS operations. We need to assure that we do not lose sight or our overall mission: the business of being there when the taxpayer calls with a question; of processing the vast number of returns, information documents, and refund checks timely and accurately; and of enforcing the tax laws to identify and collect revenues that are currently owed to the Government.

It has become clear that we are unable to carry out these responsibilities within current resources. The budget base is simply inadequate to deal with the complexities faced by tax administration today.

The needs of the tax system are great, but the benefits work directly toward the objectives of deficit reduction and a balanced budget. We have been working closely with the administration to identify the basic needs of the tax system.

GRAMM-RUDMAN-HOLLINGS

Along with other agencies, the IRS fiscal year 1986 operating budget is being cut by 4.3 percent under the Balanced Budget and Emergency Deficit Control Act of 1985. In our case, this amounts to $157 million. As you know, these cutbacks make no distinction between agencies that produce revenue and agencies that spend revenue.

FISCAL YEAR 1986 SUPPLEMENTAL REQUEST

I will first cover briefly our supplemental request and then outline the budget needs for fiscal year 1987. In these difficult budget times, we have been through an extensive and rigorous review of what is needed to carry out our basic responsibilities.

These needs total 6,950 positions and $340 million in supplemental funding for fiscal year 1986. There is no question that this request is substantial. There is also no question that it represents an investment that must be made if we are to treat taxpayers as they deserve to be treated and collect the revenues.

Congressional approval of these resources will be decisive in this regard. Early and favorable action on our supplemental is of urgent importance to the tax filing season which is now well underway.

RESTORE EFFECTIVENESS TO TAX PROCESSING

The major part of this request, 5,558 positions and $140 million, is required to overcome deficiencies in our tax processing system and restore it to full effectiveness. With these resources we are implementing realistic production rates in our 10 service centers. We are improving the quality of processing operations across the board by enhancing review of taxpayer notices before they are issued, improving management oversight, assuring quality control, increasing key verification of tax return data, stepping up the monitoring and control of refund returns, and increasing computer room staffing at our 10 service centers to provide for continuous, 24-hour-a-day, 7-day-a-week operation. In addition, resources are needed to clear up inventories of unpostable accounts, adjustments and taxpayer correspondence, and also to compensate for the decline in recall and retention of experienced seasonal employees.

IMPROVE TAXPAYER SERVICE

An additional 670 positions and $41 million are needed to keep pace with the increased demand of taxpayers for assistance. This request includes funds to cover toll-free telephone circuitry and to begin phasing in the capability for online, immediate tax account adjustments, resolving difficulties, and avoiding repeat notices and calls.

MAINTAINING TAX ADMINISTRATION AND ESTIMATED REVENUES

An essential part of this supplemental is to fund certain basic costs of doing business. Additional resources of $42 million are required to cover mandatory costs to reimburse the General Services Administration for rent of space IRS currently occupies, to finance higher cost of employee relocation resulting from changes in laws and regulations, and to meet rate increases in toll-free telephone circuitry and the lease of toll-free equipment systems for taxpayer service. We have no choice but to incur these costs.

In last year's appropriations hearings, I spoke of plans for a major revenue initiative being proposed by the administration to recover significant tax revenue currently going unreported. For fiscal year 1986, 332 positions and $14.5 million will enable us to begin hiring and training agents for this multiyear initiative. In the same manner, supplemental funds of 63 positions and $2.7 million are needed to step up resolution of tax shelter cases that are backlogged in the appeals process. These cases represent billions in revenue.

We must also process the dramatically increased volume of currency and cash transaction reports. An additional 255 positions and $6.1 million are required. These documents are used by all law enforcement agencies, and are a key element in combating organized crime and drug trafficking.

Supplemental funding is critically needed to prevent severe staff reductions this year in our enforcement functions and thus ensure Federal revenue receipts planned for fiscal year 1986. The amount needed, some $72 million, represents $1 billion in revenue collections.

Finally, our request includes $3.6 million to improve enforcement training, $14.8 million for enforcement-related automated data processing needs, and 72 positions and $3 million to increase examination of domestic corporations engaging in international activities.

SUMMARY OF FISCAL YEAR 1986 SUPPLEMENTAL REQUEST

In summary, Mr. Chairman, to my knowledge, the Service has never had a more critical budget need than that represented by this request. The successful, uninterrupted operation of the Internal Revenue Service this fiscal year depends on this supplemental being fully appropriated.

We are already cutting and deferring expenditures whenever possible and wherever possible to meet our Gramm-Rudman-Hollings reduction.

The high priority that we must give to prompt and accurate processing of returns and to taxpayer service is such that any reduction to this supplemental would necessarily fall on our tax enforcement operations. Employee furloughs would be necessary. Large revenue loss would be unavoidable. Significant reductions would make it impossible even to provide adequate taxpayer service and timely tax processing, resulting in busy signals on taxpayer service phone lines, processing delays, late refund checks, and taxpayer frustration.

The American taxpayer deserves better than this. The resources requested are already being incurred as we approach the busiest phase of this tax filing season. We have implemented numerous improvements to ensure a smooth, effective filing season this year. However, we cannot continue to operate at this level without the urgently needed funds.

A great deal is at stake. Potentially, well in excess of $1 billion in revenue receipts and more importantly renewed public confidence in a tax system that works.

FISCAL YEAR 1987 BUDGET REQUEST

Mr. Chairman, our budget request for fiscal year 1987 is in keeping with the goal of reducing the Federal budget deficit and the need to carry out our basic responsibilities to the taxpaying public.

This means providing a high level of service to taxpayers when they require information to file or have questions concerning their account, and processing their returns expeditiously and accurately.

It also means collecting as fully as possible the revenues which are owed. This budget will also enable the Service to continue as one of the Government's principal agencies in combating organized crime, drug abuse, and money laundering.

In order to meet these responsibilities, the IRS requests an appropriation of 95,084 positions and $4.1 billion, an increase of 1,360 positions and $272 million over the fiscal year 1986 proposed level.

This budget would put tax administration on a strong and sound footing. The Internal Revenue Service has a unique and vital role in deficit reduction. In fiscal year 1987, IRS will collect $800 billion in tax revenues, over 90 percent of all Federal revenues.

For every $1 cut from the IRS, other Government programs would need to be cut $10 to meet the deficit reduction targets.

REVENUE INITIATIVE

This request includes an increase of 2,500 positions and $94.4 million as the first full year of a major revenue initiative. Under this initiative, we will add 2,500 positions each year for a period of 3 years, fiscal years 1987 through 1989, to examine additional tax returns. The result of all this will be to increase revenue collections by $4.7 billion during the 3-year period, and by retaining these resources in fiscal years 1990 and 1991, we will collect an additional $5.6 billion for a total revenue gain of $10.3 billion.

Mr. Chairman, this initiative represents a method of increasing Federal revenues without raising taxes. It would identify taxes which are already due and owing to the Government. We estimate that unpaid and unreported tax liability currently totals over $100 billion annually.

DOCUMENT MATCHING INITIATIVE

An additional 795 positions and $21 million are requested to expand document matching. Under the Document Matching Program, the Service systematically matches information returns such as wage, interest and dividend statements with the related income tax returns. Through this matching process the Service is able to identify, verify, and correct income reporting discrepancies or nonfiling of tax returns, and to collect any additional tax due, or refund any overpayments.

With the requested resources, the Service will increase the volume of underreporter contacts in fiscal year 1987, and expand its program to correct erroneous taxpayer identification numbers. Additional revenue collected in fiscal year 1987 from this initiative should total $167 million.

TAX SHELTER INITIATIVE

To expedite resolution of tax shelter cases backlogged in administrative appeal and tax litigation, we request 465 positions and $20.6 million. This initiative is proposed to reduce the number of tax shelter cases representing some 372,000 tax returns now in our inventory within the examination function.

These cases will be proceeding to the administrative appeals and tax court dockets within the next few months. Already, there is a nondocketed inventory in the appeals function of over 41,000 units involving over $18 billion.

In addition, the tax litigation function is working with a tax court inventory of over 73,000 units involving almost $15 billion. This tax shelter initiative will accelerate the collection of tax revenues by some $600 million in fiscal year 1987.

AUTOMATED DATA PROCESSING AND SYSTEMS MODERNIZATION

This request includes 82 positions and $51.8 million to continue implementation of ADP modernization projects begun in prior years. We will continue the fully implemented automated collection system which has streamlined our office collection function and accelerated revenue collections.

Under the automated examination system, we will provide portable computers to all revenue agents. We will implement several key enhancements to our highly automated document matching program, and we will continue to pilot such projects as electronic filing and laser storage of tax return data.

We must continue our forward movement in applications of information technology to tax administration. We simply cannot afford to let state-of-the-art technology pass us by.

MAINTAIN TAX ADMINISTRATION

Resources totaling $84 million are needed to cover mandatory costs and workload increases. This is a net requirement after certain nonrecurring funds from the prior year. In fiscal year 1987, we will process 3.5 million more tax returns and supplemental documents, maintain our commitment to the President's task forces on organized crime and drug enforcement, and provide tax law and account assistance to 65 million taxpayers through direct assistance or taxpayer education.

ORGANIZED CRIME AND DRUG ENFORCEMENT

Finally, Mr. Chairman, within the overall budget, the IRS will contribute substantial resources to combating organized crime and drug abuse. In fiscal year 1987, we will devote more than 1,300 positions and $61 million to drug enforcement alone.

The IRS contributes 442 positions, more than one-half the resources spent by the Treasury Department, on the President's task forces on organized crime and drug enforcement. Since the inception of this effort, IRS has participated in two out of every three cases, a level second only to the Drug Enforcement Agency.

From the inception of the task forces through December 31, 1985, some 1,050 indictments and 657 convictions have already been made. In addition, the IRS contributes resources in the amount of 145 positions to the strike forces aimed at organized crime. Finally, the IRS is responsible under the Bank Secrecy Act to process currency transaction reports where we have experienced a 350-percent increase in reports filed in 1983 to 1.8 million in 1985, as well as investigate money laundering.

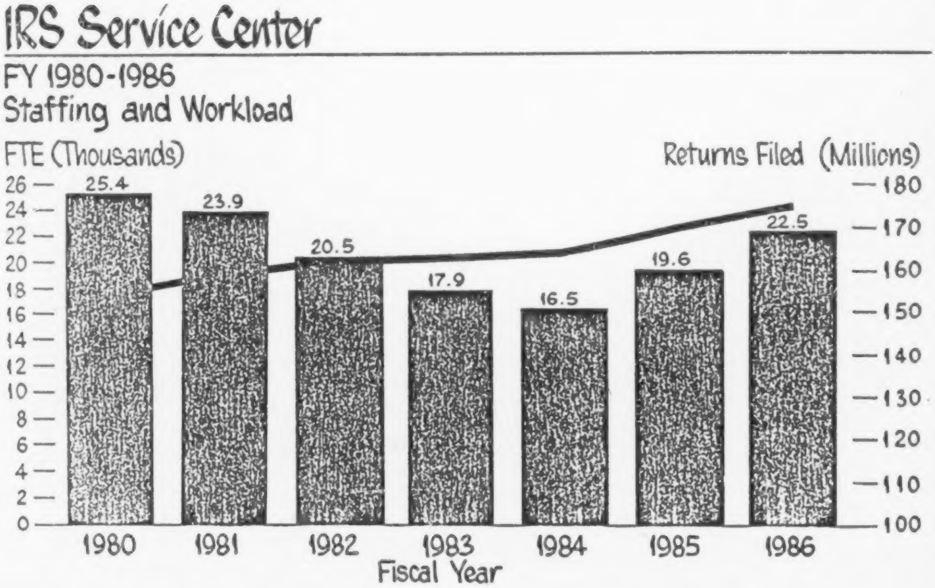
SUMMARY

In conclusion, I would like to emphasize that the objectives of this budget request are to continue to devote the highest priority to tax processing and taxpayer service operations, and to collect additional tax revenue and enhance compliance with the Nation's tax laws.

Let me close by thanking the committee for its support over the last 5 years. I have enjoyed working with you and extend my personal best wishes to each of the members of the committee. Mr. Chairman, we would be happy to take your questions.

Senator ABDNOR. Thank you very much, Commissioner.

Mr. EGGER. If I could, Mr. Chairman, we have just a few charts here, and they tend to emphasize some of the points that were made in the process. The first chart shows the relationship between our staffing and our workload over the period of time from 1980 to 1986 on an estimated basis. The blue line is the workload, and the green bars represent staffing.

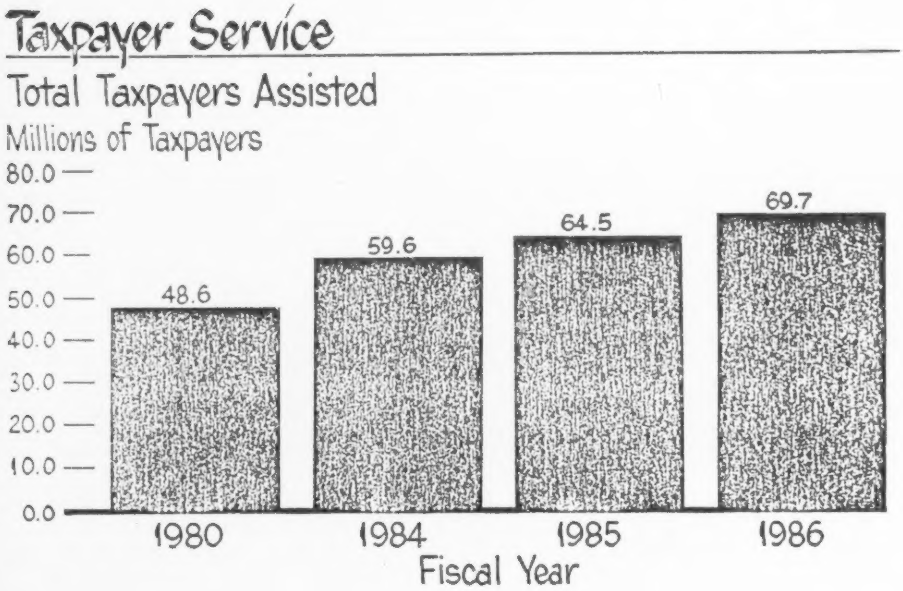

IRS Service Center

FY 1980-1986

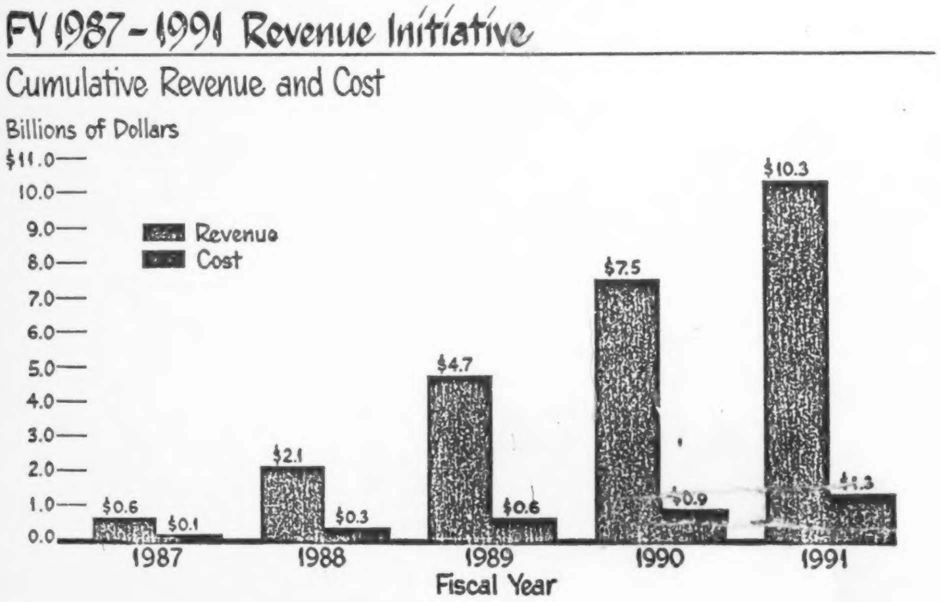
Staffing and Workload

As you can see, when we got into 1984, Mr. Chairman, our staffing had dropped from nearly 26,000 in tax returns processing down to about 16,500. We estimate that in order to maintain the kind of staffing we need in these service centers that we are going to have to go back up much more in tune with the workload level. We forecast needs for this current fiscal year at 22,500 people.

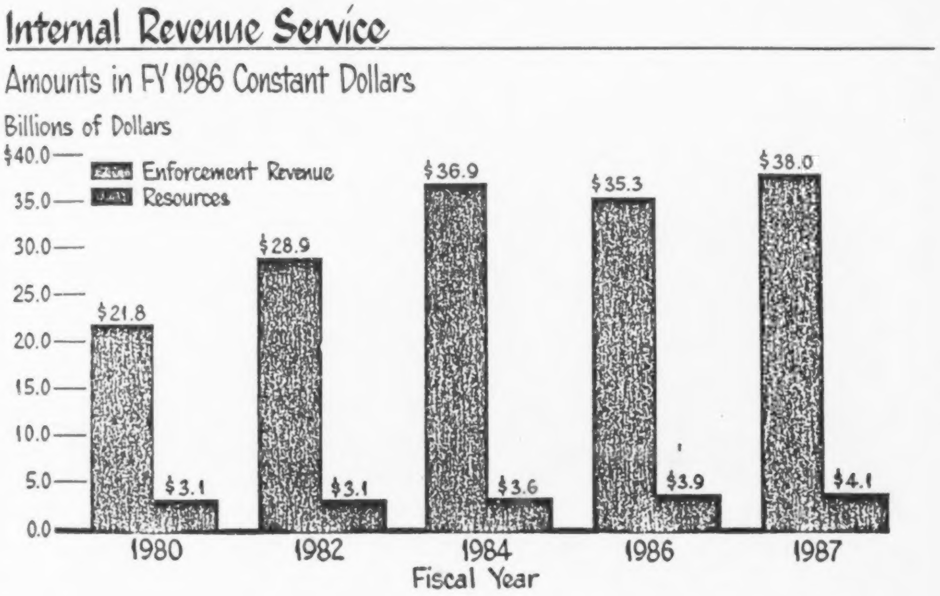
The next chart indicates graphically, Mr. Chairman, the relative volume of taxpayer service and the number of taxpayers assisted in basically our toll-free telephone and the walk-in service in our posts of duty around the country. It went from 48.6 million taxpayers assisted in fiscal year 1980 to nearly 70 million people in fiscal year 1986.



The next chart is the revenue initiative and its relationship to the cost. This is the 3-year initiative of 7,500 positions in examination and then carries it on out into 1990 and 1991. As you can see, Mr. Chairman, the cumulative cost of the program through 1991 is $1.3 billion, and the revenues collected from that will be $10.3 billion so it is essentially a 10 for 1, $10 for $1 return on the cost.



The next chart is an indication of the amounts of dollars that we have collected from enforcement activities. Now this is strictly enforcement and has nothing to do with the much larger dollars that were collected simply through the processing of returns where the taxpayers were voluntarily complying, but this is due entirely to some sort of enforcement action that we took in the year. So as you can see, in 1980—and these are all in 1986 constant dollars, by the way—in 1980, our budget was $3.1 billion, and we collected $21.8 billion. The cost in constant dollars up through 1987, as we forecast it, only goes up $1 billion.



But as you can see, the dollars of revenue climb all the way to $38 billion in fiscal year 1987. And then finally, Mr. Chairman, just a quick rundown on the responsibilities that this agency has in fiscal year 1987. We will process 180 million primary returns. We will be issuing some 80 million refunds and processing about 1 billion information returns. These are the 1099's and the W–2's.

IRS Program Responsibilities, FY 1987

Tax Returns Processed	180 Million
Refunds Issued	80 Million
Information Returns Processed	1 Billion
Total Tax Revenue	$800 Billion
Direct Enforcement Revenue	$ 38 Billion
Taxpayers Assisted	65 Million

Major Partner in Efforts to Combat Organized Crime and Drug Abuse

Our total tax revenue collected will be $800 billion. That is out of a total Federal revenue of about $850 billion. Direct enforcement revenue of $38 billion, and we will be assisting 65 million taxpayers in the country in their compliance with the tax laws.

Finally, I do not want you to overlook, Mr. Chairman, that we are a major force in the efforts to combat organized crime and drug enforcement in the Government. That is so often overlooked as a major part of our efforts.

Senator ABDNOR. Thank you, again, Commissioner. Those are very revealing figures. I am very pleased that Senator DeConcini has joined us. He is the ranking minority member of this committee and a very, very important part of it. Senator DeConcini, you have been quiet. Please start out.

Senator DECONCINI. Thank you, Mr. Chairman. Let me join you. Mr. Egger, you and I have had a few disagreements here, but I join the chairman in complimenting you for the work you, your staff, and administrators have done. It is no easy job, by any means, and any criticism I have lodged to you is, hopefully, in a constructive manner. I have to agree with the chairman that you have done a good job.

You have held that position, I think, longer than anyone I can remember. It is no easy job and I compliment you for it. Indeed, you deserve a good rest if that is what you are going to do, or make more money if that is what you are going to do. In anything, I wish you well.

TAXABILITY OF CAMPAIGN DONATIONS

I do have some questions, Mr. Chairman. The president of common cause, Mr. Egger, Fred Wurthmire, wrote to you in January regarding news stories about the National Republican Senatorial Campaign Committee that indicated there have been some violations in IRS tax laws. Has the IRS undertaken a review of this matter in order to determine if donations from campaign committees must be included as income by individual Senators, and if the law is being complied with?

Mr. EGGER. Yes, Senator DeConcini; when we received that letter we had also read about the issue in some news reports, and so we have notified our field offices in the examination function to be particularly looking for that issue to determine whether there have been any instances where tax liability is understated.

As you know, Senator DeConcini, a lot of that money under the way the tax law is applied here, to the extent that the money is spent for so-called office expenses, then it does not become taxable to the individual.

I happen to have had the fortune to serve on that commission that looked into the administrative process in the House of Representatives some years ago, then known as the OBE Commission, and at that time we dealt with a similar issue there called the office accounts, and people were making so-called campaign contributions, and then they were being converted to office accounts.

The House, under its own rule, as a result of our look-see concluded that they would no longer permit that kind of action although there is nothing illegal about it, as I understand it. But then to compensate, they voted each of the Members of the House at that time an additional $5,000 in their accounts to make up for it.

So what we have is a case where some of these contributions are being used, I believe, legitimately for office expenses of the individual members. But where they are not, where they are used for personal use, and obviouslv they are taxable income and are——

Senator DECONCINI. What is the timeframe, Mr. Commissioner, for the completion of the review? Do you have a quota—3 or 4 months?

Mr. EGGER. We simply notify the field, and they will be applying it in the cases that are selected for examination. We have no project that we would simply go out and start pulling all the tax returns of individuals.

Senator DECONCINI. Mv concern is and I hope that you would come to some conclusion that the IRS would make the information available to the general public, and of course to this committee and my office. I want to know because it is not a Republican Campaign Committee loan by any means.

Mr. EGGER. Right.

Senator DECONCINI. It just so happens that they were the subject of the letter that was sent to you. Additionally, it might be useful if the IRS would publish some guidelines for public offices—certainly Senate offices—detailing how compliance with IRS regulations can be attained.

Mr. EGGER. Yes.

Senator DECONCINI. It is a very sensitive situation here because I think that all of us, Democrats and Republicans, do not misuse those funds, both as to our own rules and ethics here, but more so as to the IRS laws. Is there any chance that you will issue some guidelines or make your conclusions available, or do something to help us all understand it, including the public?

Mr. EGGER. Obviously, we could not make conclusions with respect to individual examinations.

Senator DECONCINI. No; but you could come to some general conclusions; could you not?

Mr. EGGER. Right.

Senator DECONCINI. Of what does fall in as income and what does not?

Mr. EGGER. We can certainly do that, and we can certainly, I believe, outline for you and this subcommittee——

Senator DECONCINI. Will you do that?

Mr. EGGER [continuing]. And the Senators, in general, of what is appropriate and what would be subject to tax.

Senator DECONCINI. Will you undertake to have that done?

Mr. EGGER. Surely.

Senator DECONCINI. In what kind of a timeframe are we talking about, or would you like to let us know? I do not want it tomorrow, but maybe next week or next month.

Mr. EGGER. Yes; I understand. We will put it together very quickly and get it up to you certainly.

GRAMM-RUDMAN-HOLLINGS REDUCTIONS

Senator DECONCINI. That is fine. Thank you. Let me ask a couple of questions about your numerous programs and other increases in the request for the restoration of $156.6 million sequestered on March 1 under the Gramm-Rudman-Hollings Debt Limit Act. On page 16 of your budget justification, you outline the functions that were affected by the first sequester including administrative travel, overtime, discretionary training, procurement of supplies, office equipment, furniture, outside contracts, and several other things.

Frankly, I do not object to any of these cuts. These are, I think, exactly the type of lower priority activities that should be trimmed back in tough budget times. In fact, in your justification, you admit that these cuts would not adversely affect your ability to fulfill IRS basic missions.

So why should this committee restore any of your Gramm-Rudman-Hollings' cuts that took affect in March?

Mr. EGGER. The kind of cuts that are made here are stopgap. They are training. They are administrative travel. They are hiring in administrative functions. So in the short term what happens is the work has to get done, so we wind up using——

Senator DECONCINI. In other words, the cut was taken in 1986, under this sequester, because you really had no choice, and these are the things you cut. Now 1987 has come along and you need them, and so you put them back. In other words, they are no more than one-time cuts that you can afford in your judgment?

Mr. EGGER. To continue to try to do a balancing act to get along to minimize the use of enforcement personnel in essentially administrative roles; yes.

Senator DECONCINI. Yes; like administrative travel, if you can cut it. If you cut office equipment, outside contracts, and furniture in 1986, why can't you cut at least some of that, if not the same amount, in 1987?

Mr. EGGER. Some of it will be.

Senator DECONCINI. Are you not just as hampered in 1987?

Mr. EGGER. Of course.

Senator DECONCINI. As you were in 1986? If you cut them in 1986, does that not destroy some of your ability?

Mr. EGGER. Of course.

Senator DECONCINI. So in 1987——

Mr. EGGER. Training is a good example. As you can see, some of the problems that we ran into last year were a result of simply lack of adequate training. We have tremendous numbers of new hires in some of our service centers this year, and we are struggling with very inexperienced personnel.

For example, in our service center down in Austin, TX, over 95 percent of the seasonal people down there have never been in a service center in their lives before. So if we defer and defer and defer training, then they cannot really expect——

Senator DECONCINI. Eventually you have to do it. Mr. Chairman, I have a lot of questions, and I will submit most of them. But I will ask one more if the chairman will permit me.

Senator ABDNOR. Go right ahead.

HIRING FOR FISCAL YEAR 1986 SUPPLEMENTAL REQUEST

Senator DECONCINI. Commissioner, as I understand it, you are requesting a supplemental of $340 million to improve your taxpayer service, bolster tax processing effectiveness, and strengthen tax enforcement. This supplemental will increase the average positions, if I read it right, by 6.950. This funding would also cover so-called unanticipated mandatory cost increases.

For at least the second time in 4 years, the IRS has committed what I cannot understand to be a valid approach to budgeting. They have already hired new personnel—unless I am mistaken—and committed funds against a supplemental request before the Congress hasn't even had a hearing, or certainly a markup on the supplemental request.

Your staff admitted to my office almost 1 month ago that your agency was, in fact, staffing up to the new supplemental level to get a jump on the tax filing season. That is a very frank, honest reason. Frankly, Commissioner, regardless of the merits of doing that, and I can see that, it just seems to me you are putting the taxpayer and the Congress in a heck of a box. If we do not provide the money for those people you have already hired, you are first going to have to layoff the people you hired without congressional approval; and second, you make us out as the bad guys. We are supposed to appropriate money here, and if the need is there, let us decide that and not you. And I just have a hard time now on principle, not the merits, because your merits are there. You make a heck of a good case, but on principle, it really bothers me.

My staff requested a legal opinion from the IRS as to the legality of operating in such a fashion without an actual appropriation. We have yet to receive any answer. So my questions are simple. Why did you approve the hiring of new personnel before the expenditure of supplemental funds was approved by Congress, and why does the IRS persist in spending in the absence of Congress, and when am I going to get an answer to my request for a legal opinion?

Mr. EGGER. Senator DeConcini, the budget process, as you know, does not always fit the timing of how we have to deal with the taxpaying public. If we had had to operate in this filing season at the level not including the assumption that the supplemental budget would have been enacted, I can assure you that we would have had a further disaster in the processing of returns and refunds this year.

I cannot believe that as a responsible public official that that was my responsibility to ignore that problem.

URGENCY OF SUPPLEMENTAL

Senator DECONCINI. But, you know, there are emergencies that come out. The Commodity Credit Corporation ran out of money, and what did Congress do? The case was made and on an emergencv basis, we passed them an urgent supplemental. Why can't the IRS do the same thing?

My point is how do you justify hiring these people when this committee and the whole Appropriations Committee has not even passed your money? Are you not really taking on legislative prerogatives here?

Mr. EGGER. No, sir; we have applied to the Office of Management and Budget.

Senator DECONCINI. And they have approved it?

Mr. EGGER. They have concurred in providing to the Congress a deficiency apportionment which is being transmitted, I believe, to the Speaker of the House and the President of the Senate.

Senator DECONCINI. But that has not been approved, has it?

Mr. ROGERS. Yes; it has, sir.

Senator DECONCINI. By OMB?

Mr. ROGERS. Yes; it has, sir.

Senator DECONCINI. Yes; I will tell you what is going to happen if we do not appropriate the money?

Mr. EGGER. What is going to happen if you do not appropriate the money is that we will have to immediately cut back on the spending, and that will mean a cut back in enforcement and then a following cut back in tax return processing and refunds.

Senator DECONCINI. What you are doing to us, really, is creating an entitlement program, and I do not know how the chairman feels about it—I have not talked to him—but I am not going to play that game as good as you are, and you are great on enforcement. If you play it straight with this Senator, you get the money. But if you are going to go around and hire these people and go down to OMB and get their approval when there is a process—an emergency supplemental—you are not going to have this Senator's support. I do not care how many billion of dollars you can get.

I just cannot believe that IRS, an agency that is supposed to be the prime example out here of compliance with law, would go ahead and do this in just total disrespect of the congressional prerogatives of appropriating money.

Mr. EGGER. That is not intended in any sense as disrespect, but as you know, the fiscal year begins on October 1, and our budget process is such that it does not even get through the administrative portion of the process, much less the legislative side of it until well after the year begins. As a consequence, we wait until the Congress does appropriate the funds, and by then it is too late.

Senator DECONCINI. Well, we were in October of last year. We were in November and a good part of December. We have been all of January, and now we see this supplemental coaxing along with OMB lighting a fire under it.

Mr. EGGER. But our budget was only approved almost at the 11th hour.

Senator DECONCINI. I do not know about the other two urgent supplementals, or if their budget had been approved. But they ran out of money. Is that not really what you have done? Have you not concluded, Commissioner, that you are out of money for the purpose of complying with the next tax season, and that you do not have the money to hire the people?

Mr. EGGER. No; we have not run out. We will have to immediately adjust our sights and adjust our process and our procedures including personnel.

Senator DECONCINI. Well, then what you are saying is you want more people, and the Congress be damned. We do not care if you approve it or not. We are going to hire them. And maybe you will give them to us, and if you do not, fine. If you do not, then we are going to blame you for not having the money and the personnel to do our job. That is really what you are telling me in a very nice way.

Mr. EGGER. I do not think I am saying that, Senator DeConcini. What I am saying to you is that the process is such that unless we can anticipate the budgeting needs 2 years or so ahead when we need it, we cannot do as you suggest.

We cannot anticipate every possible catastrophe or every possible turn of events 2 years ahead.

Senator DECONCINI. How would you respond if Customs, for instance, decided that, well, by gosh, to do the Air Interdiction Program we want to do, we need 1,500 more people and two P–3 airplanes, and we are going to put them in a supplemental; we are just going to go hire those people? And OMB says sure, gosh, we are for drug interdiction. What if every agency did that?

It just boggles my mind, Commissioner. It really does.

Mr. EGGER. Senator DeConcini, I assure you this agency has no intention—I have no intention that this agency is going to overspend its budget. But on the other hand, we have to be realistic.

Senator DECONCINI. Excuse me, Commissioner. If we do not give you the supplemental, will you overspend your budget?

Mr. EGGER. No; indeed. No; indeed.

Senator DECONCINI. So we do not have to give you the supplemental?

Mr. EGGER. If you do not give us the supplemental, we will call a halt, and you will see a fine disaster.

Senator DECONCINI. Yes; that is exactly what I am saying. You are going to lay the disaster on our doorstep because if we do not give you the money, you will have to fire the people you already hired.

Mr. EGGER. I am trying to tell it like it is, Senator DeConcini.

Senator DECONCINI. You are not telling a straight story, Mr. Commissioner, because what you are doing is without approval of Congress, the people who have to vote on the money—I have got to answer for that money—and you go ahead and hire the people.

If we do not give you the money, then you are going to say, "Oh, we have got a disaster." And that is a heck of a way to run a railroad, particularly when there are emergencv supplementals that come up here. If there were not any, then I would say, OK, that is the process; we ought to change it. But there are, and you know about them as well as I do.

Mr. Chairman, I will not go any further——

Mr. EGGER. I understand that the process is a notification of the Congress with regard to a deficiency apportionment. We are doing that. And putting the supplemental on an urgent basis, and we are doing that.

Senator DECONCINI. I submit the rest of the questions, Mr. Chairman, for the record.

Senator ABDNOR. Fine. As long as we are on that subject——

Senator DECONCINI. Maybe you have an answer, Mr. Chairman.

Senator ABDNOR. No; I have no answer.

Senator DECONCINI. I get a little bit upset.

Senator ABDNOR. I do not really blame the Commissioner for this. What makes it doubly tough forgetting the major argument that you are making, I guess the thing that bothers me the most is OMB itself——

Senator DECONCINI. Sure.

Senator ABDNOR [continuing]. Carried this October 18 letter in answer to the legislation we passed in Congress and we tried to put people into the IRS because we agreed, Commissioner, they surely needed more. I guess I would not be quite so sensitive if they did not earmark that thing in the letter to me saying that they were going to recommend a veto of the bill. But one of the reasons—there are other reasons in it, I will grant you—and I guess the postal subsidy was certainly one of them, and they thought we put too much in for Customs. But one of the big items for vetoing our bill was a $78 million increase for the IRS.

Again, I am not blaming. I think you wanted that, and I really wanted you to have it. I think I have been convinced because while this was going on, the Reconciliation Committee in the Finance Committee was putting more people on as a way to collect more bucks. It made good sense. But we do have our problems. I do not know if you have to defend OMB sometimes. This really made us look like the big spenders and now you come along and ask for the supplemental. I agree you need it. You need it to raise some revenues, and I am not positive my taxpayer friends back home want me to be on the record saying we need more manpower, but you do. I know the job you have to do.

We are talking about this amnesty bill. This is more important to me than trying to carry out an amnestv program. I think it was unfortunate that this happened. As a matter of fact, I got another letter—I guess it is from OMB—addressed to my chairman. The administration has problems with the Senate reduction to the Treasury-Postal bill.

One of the main things was this 2 percent across-the-board cut that resulted in this reduction we made was not done by the committee. But we have a lot of problems. I have a letter from Mr. Wright today in response to the numbers. Senator DeConcini said that he does not object to the numbers. It is only the way it is being played here.

But I do know that manpower is needed. But really if we started this practice with every agency in Government, we would be in a bad way. But we will take that up at a later time. I think we are talking probably to the wrong guys here. OMB is the one we should be visiting with when they come in.

Senator DeConcini. Mr. Chairman. If the chairman would yield, I agree OMB could have put a stop to this also. But IRS makes the request, and if IRS needs it, they ought to come with an urgent supplemental and make their case up here. And OMB ought to do the same instead of putting the chairman and, for that matter, this Senator, and, I think the whole Appropriations Committee is in one heck of a spot.

Then the worst thing about it is I am torn. I think you should have the money. I think you just have an overwhelming case, and you have sympathy here, as you have in the past. To me it is just about blown away by your agency and OMB doing it this way.

Maybe we should not rely on principles, Mr. Chairman. Maybe we should just go the way of collecting the money and the heck with this process. But I still think it is important.

Senator Abdnor. We could not allow that. If it happened with every agency in the Government, we would have a lot of hollering going on. We will just have to see what comes from this. And, again, OMB will be in soon, and we can see if that is what they are going to encourage other agencies where we have disagreement.

GRAMM-RUDMAN-HOLLINGS

Let me jump over to the impact, Commissioner, of the Gramm-Rudman-Hollings. I would like for you to comment on that, and expand in detail for the record, if you will. I do not expect you to try to cover the whole waterfront. But give us a general idea and then give us more of the details because this is going to be a factor we have to look at as we go through all our agencies in trying to put together our budget with the limited dollars we have.

The Gramm-Rudman required across the board a 4.3-percent reduction in outlays for all nonexempt budget accounts including the IRS. However, within each account, the legislation allows the administration the discretion to decide which programs, projects and activities will be reduced.

Now, within each of the IRS four appropriation accounts, which programs, projects, and activities will IRS reduce to meet the fiscal year 1986 reduction mandated by the Gramm-Rudman-Hollings legislation.

Mr. EGGER. Mr. Chairman, what we are doing is giving our No. 1 priority to tax return processing, the processing of refunds, that kind of thing. And then the second priority we will be giving to the enforcement programs to make sure that we have minimized the effect on enforcement and, therefore, preserve the revenue production level from those programs, and taking as much as possible out of those activities at this point which are not revenue productive directly.

Senator ABDNOR. You will give us a more in-depth answer?

Mr. EGGER. I will be glad to give you the details of that. Yes, sir.

[The information follows:]

IMPACT OF GRAMM-RUDMAN-HOLLINGS REDUCTION TO IRS

The impact of the Gramm-Rudman-Hollings reduction will fall heavily on administrative and support functions. Within each of the IRS operating appropriations, the following actions are now being taken: restrict hiring; reduce administrative travel, overtime, and discretionary training; freeze procurement of supplies, office equipment, and furniture; suspend office alterations and use of outside contractors (management contracts, studies, tests, et cetera); and cut back, where possible, on ADP and systems modernization expenditures.

The Service is not applying reductions against filing season operations (processing tax returns, issuing refunds, providing taxpayer service) nor against direct revenue-producing programs (examining tax returns, collecting unpaid taxes, securing delinquent returns, matching information returns). Supplemental funds, totaling 6,950 positions and $340 million, are being requested for these purposes this year. Failure to approve this request will force the Service to cut back dramatically in these critical functions.

REDUCTION OF PROGRAMS UNDER GRAMM-RUDMAN-HOLLINGS

Senator ABDNOR. Encouraging voluntary compliance with the tax laws requires the efficient operation of several activities such as your taxpayers' assistance, tax return processing, examination of tax returns, and collections of taxes due. Now, considering all of these as well as other functions that are essential for IRS to work effectively, how did the IRS decide which programs, activities and projects within each budget account would be reduced to meet the requirements of the Gramm-Rudman-Hollings legislation?

Please add that to the written part. I will give you the question afterward. You do not have to answer that now.

Mr. EGGER. Let us do this, Mr. Chairman. Let us supply that because this is very much a part of the same information that we would be supplying on your prior question there.

Senator ABDNOR. Good.

Mr. EGGER. We would be glad to supply the answer to both those together.

Senator ABDNOR. Very good.

Now, this supplemental request, will that help alleviate some of the problems you are faced with because of these reductions?

Mr. EGGER. Yes; yes, to a very large extent the damage, if you will, that would be done to our programs as a result of the Gramm-Rudman reductions, sequestration, will be assisted by and restored, in effect, by the supplemental.

MANDATORY COST INCREASES

Senator ABDNOR. I guess this is one of those we should have put on the endangered list.

Mr. EGGER. I think so. Yes, sir.

Senator ABDNOR. You are requesting $42 million to meet unanticipated mandatory cost increases. Can you tell the committee what these costs are going to be?

Mr. EGGER. Right. About $42.2 million all together; $21.8 million of it is for our rent, in effect, to GSA. About $14.6 million is employee relocation under the new statutes and regulations there. About $5.5 million is for rate increases and our toll-free telephone circuitry. And the balance which is relatively small, about $300,000, is for the funding of versabraille equipment.

Senator ABDNOR. What kind?

Mr. EGGER. Versabraille. It is a piece of equipment that permits us to use blind or nearly blind people in our taxpayer service area. We are probably among the highest, if not the highest, employers of blind people in the whole Federal Government. This equipment permits them to do different kind of jobs.

Senator ABDNOR. What do they do?

Mr. EGGER. The versabraille, the equipment converts.

Senator ABDNOR. They can run that machine?

Mr. EGGER. Right. It is a machine that, in effect, converts written information into braille. I would like to have you visit our Boston office sometime, Mr. Chairman, and see some of the work those people are doing up there. It is just tremendous.

Senator ABDNOR. I would like to. I never did make it to Philadelphia. We were going to do that.

Mr. EGGER. Be glad to have you come up there as well.

Senator ABDNOR. I would rather go now than last year.

Mr. EGGER. Yes; we are very proud of what is going on up there this year.

Senator ABDNOR. I understand it is much, much better. And I do not hear from the Senators as frequently as we used to. The supplemental will fund 6,950 positions. I do not know if I asked you how they will be utilized. I guess you covered that. Maybe you could add that in writing? Add that to the written question. The 6,950, where you are going to put them?

Mr. EGGER. Right. How we are going to allocate those positions?

Senator ABDNOR. Yes.

Mr. EGGER. Yes, sir.

[The information follows:]

ALLOCATION OF SUPPLEMENTAL RESOURCES: POSITIONS AND AMOUNTS

The Internal Revenue Service is requesting supplemental funding totaling 6,950 average positions and $340 million in fiscal year 1986.

Additional resources are required to restore effectiveness of tax processing (5,558 average positions and $140.2 million).

—Restore production rates to those achieved in fiscal year 1984 (1,003 average positions).

—Compensate for the decline in recall and retention of experienced seasonal employees (375 average positions).

—Clear up unpostables, adjustments, and backlogged taxpayer correspondence (1,475 average positions).

—Improve quality of operations (2,705 average positions): Training new and current employeees (575 average positions); expanding notice review (440 average positions); improving management oversight and supervisory control (685 average positions); assuring quality control (265 average positions); increasing key verification (430 average positions); monitoring and controling refund returns (70 average positions); and increasing computer room staffing at our 10 service centers to provide for continuous 24 hour, 7 days a week operation (240 average positions).

—Provide reliable sources of electrical power for service centers ($6.7 million).

Additional resources are required to improve taxpayer service by keeping pace with the increased demand of taxpayers for assistance in meeting their tax responsibilities and in resolving their concerns on the status of their tax accounts (670 average positions and $28.9 million). Also, funds are required to cover toll-free telephone circuitry and to acquire multifunctional equipment ($11.9 million) which will allow on-line tax account adjustment. In the enforcement area, supplemental funding (722 average positions) is requested to ensure the Service's ability to:

—Insure the full revenue potential of the revenue initiative by allowing us to advance hire and train agents late this fiscal year (332 average positions and $14.5 million).

—To get a head start late in the fiscal year in hiring additional enforcement staff needed to collect additional tax revenues in fiscal years 1987–91 (63 average positions and $2.7 million).

—Process increased volumes of currency transaction reports (255 average positions and $6.1 million).

—Restructure the training given to new agents ($3.6 million).

—Fund two ADP enforcement projects—the automated collection system ($6.2 million) and the automated examination system ($4.6 million).

—Ensure the revenue forecast for fiscal year 1986 is achieved ($72.1 million).

—Increase examination of domestic corporations having international activity (72 average positions and $3 million).

The Service also requires funds to cover various mandatory costs ($42.2 million).

—Reimburse GSA for rent of space ($21.8 million).

—Finance higher costs of employee relocation resulting from law and regulations ($14.6 million).

—Meet rate increases in toll-free telephone circuitry and lease of ACD/PBS systems ($5.5 million).

—Provide funding for versabraille equipment for visually handicapped employees resulting from a suit filed in U.S. District Court of the District of Columbia on May 25, 1984. (0.3 million).

REVENUE LOSS FROM GRAMM-RUDMAN-HOLLINGS

Senator ABDNOR. Now, those positions—I asked you this earlier—are they considered as a part of your base for your fiscal year 1987 request?

Mr. EGGER. Yes; therefore, we are only asking for 1,360 additional positions for fiscal year 1987.

Senator ABDNOR. I guess I should ask you this without the supplemental because I suppose it would not be quite as damaging if the supplemental goes through. How much estimated tax revenue will be lost as a result of the Gramm-Rudman-Hollings legislation in fiscal year 1986? I suppose you are going to tell me it depends on whether you keep those positions or not.

Mr. EGGER. Yes.

Senator ABDNOR. If you did not have it, how much would this cost you?

Mr. EGGER. Basically if we did not get the supplemental then we are talking about a minimum of $1.5 billion loss in revenue.

Senator ABDNOR. $1.5 billion.

Mr. EGGER. I think with the supplemental and our ability to reprogram within our budget area, we should be able to pretty well maintain the same level of revenues that we have anticipated heretofore.

Senator ABDNOR. The real question, then, is how much is the direct result of the $157 million Gramm-Rudman-Hollings?

Mr. EGGER. Without regard to the supplemental?

Senator ABDNOR. Right. Without the supplemental.

Mr. EGGER. At least $1.5 billion, and possibly more.

REVENUE YIELD

Senator ABDNOR. Now, on the average several IRS programs yield at least $10 in revenues for each dollar of resources invested. Although all the information may not be available to measure each marginal dollar yielded, can IRS estimate how much resources would be needed to reach the average return of $2 of revenue for each $1 spent?

Mr. EGGER. Yes; Mr. Chairman, for the last several years we have been perfecting what we call staffing models. These are computer-based models into which we put a great deal of data, and within the past year we have perfected our model in the examination area to the point that we can forecast very, very accuratelv the effects of additional staffing, or reduction in staffing in the examination area.

Now, these are full cost models. In other words, when we talk about how many dollars of revenue, we are including in that the cost of collecting those dollars and taking it right on through the appeals and tax court and so on, wherever necessary.

In our collection area and in the Information Returns Program, the models are somewhat later in development, but we expect to pretty well complete the work on those models this year, and then we will be in the process of putting together an integration of all of those models so that we can very well predict them and analyze staffing proposals, staffing increases, staffing reductions, and so on.

In other words, if we wanted to say where can you put 1,000 positions so as to produce the highest revenue, our models would show that. Or we could say what if we add 1,000 positions in this or that function, what would be the result and so on.

We think it is a very sophisticated model effort. The Treasury Department and the OMB as well as outside contractors have taken a look at it. And OMB does accept those staffing models and the results of that for budgeting purposes.

Senator ABDNOR. Is that in effect now?

Mr. EGGER. I am sorry. Did I misunderstand your question?

Senator ABDNOR. I just said that is in effect now?

Mr. EGGER. That is in effect now. If you are asking what it would take to bring our ratio from 1 to 10 down to some lower figure, something like $1 to $2, it would take at least two, possibly three times the number of people we have in examination and other enforcement functions in order to achieve that. I think that we could not possibly absorb in a period of less than 10 years the number of people it would take to bring us down to that ratio.

Senator ABDNOR. The supplemental that you are asking for, I assume it comes no where near the added costs? I mean the ratio will stay 10 to 1?

Mr. EGGER. Yes, yes, yes.

ADDITIONAL STAFFING

Senator ABDNOR. If you really had all the people you wanted, how many would you have to do the job?

Mr. EGGER. I am really not sure. But it would be over a period of 2 or 3 years considerably more than we have now, mainly because our Information Returns Program, which is a very, very productive program and a very effective program from a taxpayer compliance standpoint, our nonfiler program, and things of that kind, quite apart from simply auditing more tax returns.

Right now, Mr. Chairman, we are auditing less than 1.4 tax returns in the current year—1.4 percent. And to me that kind of audit coverage at a time when the ratio is at 1 to 10 simply indicates to me as a professional that that audit coverage is inadequate to appropriately monitor the system. I misspoke. We are down around 1.1 percent now this year. With the increase in fiscal year 1987, it will bring us up to 1.4 percent.

That is about one-fourth of where we were 10 years ago.

Senator ABDNOR. Since no one knows what we are going to be doing in 1987, the Budget Committee, the Appropriations and all, but in the event we had to go through another sequestrial period, is there anything that might be anticipated if we do not take up priorities? From what you have seen in the 7 months of 1986, how would you prepare to meet the reduction that could be required of you for that year and later years? You know this Congress has this law now. Go ahead.

Mr. ROGERS. I think first, Mr. Chairman, we would attempt to get a technical change to the law and exempt IRS from the second sequestration.

Senator ABDNOR. That would help, wouldn't it? In a way, we could not put many more things in. We would not have anything left to cut.

Mr. EGGER. You know the peculiar thing about Gramm-Rudman-Hollings cuts on the Internal Revenue Service is it is kind of a reverse English, if you will. The further you cut, the more every other agency in the Government has to cut because if you cut our budget $1, that is $10 that has got to be made up someplace else. The case for it is just obvious.

ORGANIZATIONAL CHANGE

Senator ABDNOR. I do not suppose this is because of Gramm-Rudman-Hollings, but you are proposing a significant organizational change, are you not, in your Department? Could you tell us what you are doing there and what kind of an impact this will have on your operations?

Mr. EGGER. The only organizational changes that we are contemplating at the moment, Mr. Chairman, are in the international area. We have a reorganization there that will result in a consolidation of our international activities under one head rather than under two or three heads as we have been heretofore.

That change has just been approved by the Treasury Department, and we will be putting it into effect shortly. But it is not significant in terms of the taxpaying public.

AUTOMATED EXAMINATION SYSTEM

Senator ABDNOR. Let me ask you about your request for funding for portable terminals.

Mr. EGGER. Yes, sir.

Senator ABDNOR. Do you have them in place now?

Mr. EGGER. No; we have a few hundred out there that we have used for testing the program and so on. But we have just completed a contract award for 15,000 terminals that will be in place this year and next. That is over 1986 and 1987. Those will be in the hands of the field agents to begin with and then subsequently in the office audit teams.

Senator ABDNOR. Have they proven to be what you thought they would be?

Mr. EGGER. We have not had that much experience, but we are very confident that it will enhance the productivity of our field agents considerably.

TAX FORMS AVAILABILITY IN SOUTH DAKOTA

Senator ABDNOR. Every chairman ought to be able to ask a parochial question. I want to do that here. You can recall, I am sure when I spoke with you the other day, I mentioned receiving letters from a number of constituents who were expressing concerns at their inability to get tax forms. Now, I know you are trying at every turn to streamline and provide efficient service while cutting costs when you can.

I would like to read you two letters, if I may, that illustrate the questions I am getting. I hate to have you have to listen to all this, but this is a gentleman from Sioux Falls.

> Shortly after the first of the year, I recall hearing reports on the radio that the people of South Dakota were just now finding that the IRS had closed their offices within the State, and forms were no longer available. While I was not aware of the closings, I went to the local IRS office on January 2, 1986, before hearing the radio report. In the past years all the forms I needed, namely the W-2 forms, could be found on a rack in the hallway. This year the racks have been removed, and a very nice lady informed me that forms must be ordered and handed me publication 910.
>
> I placed my order on January 2, 1986, as instructed. I have enclosed copies of what was received at our office on January 17, 1986. As you will note, they have indicated the W-2 form is an unavailable publication. I guess what I don't understand is how can it be cheaper to have people answer the telephone calls, people to fill the orders, plastic bags to ship the orders in, and postage to get it to its destination. What is wrong with sending forms by the case to major points, and have them picked up by the people who need them?

That was one. Another one. This one is from another Sioux Falls' person.

> As an employee in the reference department in Sioux Falls Public Library, I feel I must register a complaint against the Internal Revenue Service for their decision to close the IRS offices in Rapid City and Sioux Falls.
>
> When informed of this decision, we were aware of the strong impact it would have on the library and the public, but we had no idea it would be of this magnitude. Since heavy use of the IRS office is limited to a few months, we were unable to gage the significance of the closing until January rolled around.
>
> We found that we are basically the only place in Sioux Falls with a variety of forms available for the public. Since we received no direction as to what forms and how many should be available, the public is finding that some of the forms they need are not available locally.
>
> Employers who need a W-2 form they formerly normally did not order. Some farmers, not only from South Dakota, but Iowa and Minnesota, as well, have received no forms at all. Here again forms we normally did not supply.

Skipping some here.

> It's difficult for the taxpaying patron to understand why we can't supply a simple form free of charge when they were told to come to their local library, why they can't get forms through the local IRS office, or reach the toll-free number because the line is always busy.
>
> I'm sure that our library is not the only one affected by the decision. Certainly, funding cuts could be made in areas that would not pass a Federal burden such as this on to local institutions with no expertise in such matters.

This is a problem. They may be isolated. But must be addressed in the future if we are going to continue voluntary tax compliance. And I have one other letter I will not read, but I hope you will look at it and make the necessary adjustments so we can avoid this problem in future years.

Maybe I am an isolated case out there in South Dakota, but I question that.

Mr. EGGER. Mr. Chairman, let me tell you what we did and why. First of all, we did not close the offices in those cities. We simply do not have the person out there for walk-in taxpayer service that we have had in the past. In lieu thereof, we have provided, in the tax package, information relative to how to obtain forms by telephone, or a mail-in. All you have to do is tear it off the bottom and send it in, and simply circle the kind of form and number of forms that you want. We are in the process of developing nationwide, toll-free telephone central forms distribution systems. The first one of that is in place in Richmond, VA, starting this year.

Clearly, it is much more efficient and a great deal less expensive to have a central forms distribution than it is to try to have forms and people in the nearly 700 posts of duty that we have around the country.

Senator ABDNOR. How much cheaper do you think? Really the other thing you have to worry about is what are you really doing?

Mr. EGGER. Let me just finish, Mr. Chairman, if I may.

Senator ABDNOR. All right. I am sorry.

Mr. EGGER. In the State of South Dakota, for example, we have gone to considerable lengths to involve the banks, the post offices, and the public libraries. There are some 129 banks, 195 post offices, 56 libraries in the State which participate in our forms distribution program.

In addition, the reason that we did it was because over the last 3 years the number of taxpayers coming into those two offices has dropped rather drastically. For example, our walk-in traffic in Rapid City has fallen off 60 percent over that 3-year period.

In Sioux Falls, it is down 50 percent, so that it is expensive to keep a person on salary in those posts of duty as well as in other posts of duty. However, after your conversation with me here a week or so ago, we reexamined it, and finally concluded that notwithstanding the costs, the taxpayers probably would not understand not being able to go to an IRS office and get forms.

So regardless of the cost at this point, we are going to put forms racks in those two offices and see to it that they are there, after which we will reexamine this whole problem over the next several years. But again, I have to tell you that with 700 or so posts of duty in this country, it becomes a very expensive proposition.

Senator ABDNOR. I appreciate your doing this for Rapid City and Sioux Falls, SD, and the people there, but I have to believe there may be other cases like this around the United States. Actually what I am really wondering is——

Mr. EGGER. We will make it a uniform rule whatever we do.

Senator ABDNOR. If you reexamine it, that is the key to it. That is more than taking care of me and my State.

Mr. EGGER. Yes; this is not just for South Dakota.

Senator ABDNOR. You have to look it over and see how it is affecting other parts of the country, and is it going to have some affect on dropping off of people. You never know what goes through people's minds. They may just say to heck with it. If I can't find a form, I won't fill one out. It will be interesting to see if you might have some of that going on.

Mr. EGGER. With the millions of tax forms that we mail out and the millions of tax forms that we make available through our centralized distribution systems, and the banks, post offices, et cetera, et cetera, it is a very, very costly proposition.

Senator ABDNOR. Are you sending forms to the individual like you used to?

Mr. EGGER. Oh, yes. Yes; the only forms that we did not send out this year were taxpayers who had filed a return prepared by a preparer, an accountant, or whatever. In those cases, we sent to those taxpayers a postcard, and if they wanted the forms package all they had to do was pull off the back and send it back to us, and we would have then mailed them a tax package. So we have not stopped mailing tax packages to anybody.

Senator ABDNOR. Those people who hire experts, accountants to do their tax return, those people do not get a next year's form unless they request it.

Mr. EGGER. Unless they ask for it; that's correct. You see, Mr. Chairman, we have gotten up to the point where something over one-half of the individual returns in this country are now being computer prepared. To that extent, they do not use the forms which we print and distribute but rather forms which are generated on computer paper and so on.

And most of those large users are duplicating their own forms and so on. So for us to continue to print hundreds of millions of forms and have them thrown away each year is a very costly thing.

Senator ABDNOR. What percent of your budget is for printing forms? Do you have any idea?

Mr. EGGER. Something like $70 million for printing tax forms and instructions, bills, and notices.

Senator ABDNOR. We do not want them to use that for an excuse for not filing returns.

Mr. EGGER. Right.

Senator ABDNOR. I would as soon lose $70 million.

Mr. EGGER. Right. We understand the point.

TAX PROCESSING

Senator ABDNOR. During 1985, the IRS 10 service centers had difficulty processing tax returns timely, controlling the flow of tax returns as they move through the processing system, and keeping nonreturns, processing case inventories at a manageable level. As a result, in 1985 more refunds were delayed than in prior years. Two, interest payments on late refunds increased substantially. Three, many taxpayers had to file duplicate returns to expedite receipts of their refunds. Four, numerous, erroneous taxpayer notices were issued. Five, correspondence and other inventories swelled. Six, the number of telephone calls from taxpayers grew. Seven, overtime costs increased. Eight, the productivity of service center personnel declined significantly.

Now, besides the obvious inconvenience to taxpayers, delays in issuing refunds cost the Federal Government money because IRS is generally obligated to pay interest on any refund that is not issued within 45 days of the date the return was filed, or the return due date, whichever comes later.

How is the processing of individal returns involving refunds proceeding this year, and how long can a taxpayer expect to wait this year to obtain a refund?

Mr. EGGER. Mr. Chairman, I am delighted to tell you that the processing of returns is well ahead of last year. It is back to what we regard as a normal processing year. Refunds are being issued today between 4 and 6 weeks. That time will begin to get longer as we get the big bulge of tax returns in the latter part of the season.

We should be climbing up to anywhere from 7 to 10 weeks, depending on the pattern of filing. This year we got returns in very slowly at the start, something like 2 million returns behind last year up until just the last 2 or 3 weeks.

We are now down to where we are only about 700,000 returns behind last year. But we are nearly 50 percent ahead in terms of processing and in terms of refunds. So we believe that the 4- to 6-weeks period that the taxpayer is experiencing right now is about the best we can hope to achieve under the present system. Keeping in mind that of that period of time, roughly 2 weeks of it is after the certification leaves our hands and goes over to the Financial Management Service of the Treasury.

Senator ABDNOR. Do you have any idea how much it costs us in the way of interest because of those delays?

Mr. EGGER. We spent about $45 million in fiscal year 1985 on interest paid on timely filed individual returns. That was about $18 million more than paid in fiscal year 1984.

Senator ABDNOR. Oh, is it? Can you hold it to the old, to the $18 million less next year, to the 1984 figure?

Mr. EGGER. Yes; part of that $18 million is a result of the fact that the interest rate was 2 percentage points higher last year than the year before. Also, the dollar amount of the refunds were higher, and so normally the interest would have been somewhat higher anyway. We expect that in this year our interest costs will be about $38 million. That is closer to the normal level.

MOTOR VEHICLE RECORDKEEPING REGULATIONS

Senator ABDNOR. Commissioner, on another subject, I am sure you knew you would never get out of here without me bringing up motor vehicle regulation laws. You know how upset I was a couple of weeks ago when I was testifying in front of your hearing group. I have calmed down a bit. It still upsets me when I think how legislation I had on the repeal from the Senate side went through 92 to 1. I realize the House put some words in the legislation that I did not like, but at the conference you take what you come out with or nothing at all.

I do not know. I felt that conference report was such that it should give you a lot of latitude. I am not suggesting that maybe you can interpret it to do what you did do.

We are confused out in South Dakota. I think I could give you some quotes on the calls we made. We found a guy who was very generous, your man. Maybe I can find what he did say. It was not tough at all. But I know some other people who called, and they were told they better have logs or else. The best way is to have your logs complete and timely. So it is really a blurred picture out there. I think you ought to state more clearly in those regulations what you do want, and I will make up my mind what I need to do after I see those.

But right now one guy can give me the word that we are not tough. All we want you to do is have some kind of proof, keep enough of a record so you can justify what you are doing, and another one indicates that you better have—all accountants tell them to play safe. In these days of being sued, I guess it scares a lot of the accountants, too.

But they tell them out my way they better keep track of everything they are doing and write it down on a daily basis. We are right back to where we were. Let me turn it over to you a second. Maybe you have something new that I have not heard about.

Mr. EGGER. I have nothing new yet, Mr. Chairman. Of course, that is the purpose of having the regulations come out in proposed form and then the opportunity to hear from the public.

Obviously, we have those hearings for the purpose of getting information from people who have to live with the rules. Our own people in the field have to have guidance, and we are going to look closely at those rules to see whether there is basis for and an opportunity to further clarify what is needed.

We have to do that obviously for the guidance of our own examining officers as well as for the taxpaying public. Insofar as what the accountants are telling people, having been in that profession myself for a long period of years, I can assure you that it is always easier to be conservative with your client than it is to tell him what the very last thing that he needs to do.

Senator ABDNOR. That is the dilemma we find ourselves in, and let me tell you, it is not a very popular thing. I started feeling the impact of this several months ago, and I keep getting it. Mr. Abdnor tells us they have helped us out of this mess, and now my accountant tells me I have to keep track of everything. They wonder what we are going to do this past year because they did not keep those records. They were led to believe—maybe it is my fault—but I thought they were reasonably free of having to write down every mile they traveled. I do not think the rules came out to tell them otherwise until after the start of the year. So, for no other reason, there was quite a period of time they were almost innocent if they did not keep the records.

Mr. EGGER. I think we have made it clear in the regulations, and we will look at it to be even further clarifying.

Senator ABDNOR. I will be waiting to see it. You let me know and then I will know what I want to do.

Mr. EGGER. Fine. We will do that, Mr. Chairman.

Senator ABDNOR. Wait a minute. We have a couple more questions.

Mr. EGGER. All right.

TAX AMNESTY

Senator ABDNOR. I have many questions we are going to submit to you in writing here. But one we ought to discuss briefly because it seems to be a very timely subject. Everyone is talking about it. Legislators and congressional people are talking about it. Amnesty. I do not know if you have any thoughts on that, but a number of States have been using amnesty programs as a means of increasing compliance and reducing the large volumes of delinquencies.

Now, during the fiscal year 1986 appropriations hearings, IRS mentioned that it was studying the results of various amnesty programs and expected a report in June 1985. Has IRS completed its study of amnesty programs, and if so, what were the results?

Mr. EGGER. We were able at that time only to get the rather superficial information on a lot of the State programs, primarily because the States themselves have not done an in-depth analysis or profiling of the taxpayers who have come in under their amnesty programs.

That information still is not available to us in the degree and to the extent and in the scope that we would like to have it. But we and the Treasury are continuing to look at amnesty simply because there is so much interest in it both here on Capitol Hill and in the public generally.

Senator ABDNOR. I am sure you would be as close of an authority on this as anyone. What potential effects would a Federal tax amnesty program have on taxpayers' compliance?

Mr. EGGER. I have my personal view which is that I have very grave misgivings about an amnesty program on the ground that people would believe that somehow or other they have not been dealt with fairly if they have paid their taxes regularly and conscientiously only to have somebody who has scoffed at the tax laws get off scot free and not have any downside risks.

I think the other thing that concerns me in the compliance area is that amnesties, by and large, tend to be repeated. The concern there is that people would simply begin to wait for the next amnesty to come around.

Senator ABDNOR. Yes; you could see a drop off in returns.

Mr. EGGER. I might tell you that I was outside the country here a couple of years ago, and I spoke to one of my counterparts in another part of the world. And I said to him have you ever tried an amnesty program in your country, and he said, oh, my goodness, yes. We have one every 5 years. [Laughter.]

Senator ABDNOR. I have wondered about it. I know it seems to be a popular thing right now, but it seems to me it could——

Mr. EGGER. I think it needs to be looked at very carefully from the standpoint of will an amnesty program at the Federal level really provide any revenues of consequence, and if you put an amnesty program together, you must put together the stick part along with the other.

Senator ABDNOR. Yes; you have to have the enforcement.

Mr. EGGER. My personal judgment is that if you did that and did the things that I believe would have to be done to make it work, then you probably would not need the amnesty.

Senator ABDNOR. Well, if you had it and somebody came in and said here I am. Iwant to square up with the world under the proposal. Do you go through that with a fine-toothed comb and see if he is admitting everything then?

Mr. EGGER. Yes; I would certainly think we would take a look to make sure that he is not like the taxpayer who sent in the $500 because he could not sleep and his conscience bothered him so much. Then he said if he still is not able to sleep, he will send the rest. [Laughter.]

Senator ABDNOR. It is something we are going to be dealing with, and we really don't have much to go on for research and background either except, as you say, states.

Mr. EGGER. Right. It is very hard to estimate anything in the way of revenues which would be forthcoming purely from the amnesty itself. I am not talking about the additional enforcement effort that we might make.

TAX REFORM PROPOSALS

Senator ABDNOR. Let me get into the tax reform proposals for just a minute. This past year you have seen quite a few proposals for tax reform including H.R. 3838 passed by the House on December 17, 1985. To what extent has IRS been involved in developing or furnishing data to help estimate the impact of the effects of the tax reform proposals? Are you getting consulted on that?

Mr. EGGER. Yes, Mr. Chairman; our role in this whole effort started from the very beginning back in January 1984 when the President instructed the Secretary of the Treasury to go forward with the development of a tax reform package. The former Secretary and the current Secretary both have asked that I be personally involved in it. Then we have taken it upon ourselves working with the Office of Tax Policy in the Treasury to put together a team of people who are experts in certain areas of the law, or in the examination of tax returns, things of that kind so that we can serve as an advisory group, if you will, to the Treasury with respect to the administrability of various provisions and so on.

We provide our comments to the Treasury and then they in turn evaluate and/or use those comments as they see fit.

Senator ABDNOR. Does the IRS have any specific resources included in its fiscal year 1987 budget directly related to tax reform proposals?

Mr. EGGER. No, sir; we are using our existing personnel on a part-time basis for that purpose.

Senator ABDNOR. How much time would IRS need to implement tax reform legislation of the nature proposed by H.R. 3838 without undue disruption?

Mr. EGGER. Our expectations are that we could begin implementing parts of the bill almost immediately, but that development of forms, the development of regulations and rulings, that is interpretative regulations, would take us, we believe, over a period of 2 years. And even that in order to achieve that, we would have to probably depart somewhat from the pattern that we normally follow of developing regulations sort of one at a time.

In that case, we would try to use things like information releases, things of that kind, to provide guidance to the taxpaying public. But it is an extensive period.

Senator ABDNOR. It may happen here. We are going to have to prepare for it.

Mr. EGGER. Right.

TAXABILITY OF BUSINESS VEHICLES

Senator ABDNOR. It looks like something is going to be coming out of this Congress before they get through. I know it is getting late, but I have two more questions for the National Association of Counties that I have been dealing with. Many county governments and rural States—and I am back off of taxes for 1 minute—such as South Dakota require that certain employees take their vehicles home with them after work in order that they may be available on a 24-hour-a-day basis to respond to emergencies.

An example of these employees are those that work for the highway or public works department, civil defense, parks and recreation, and so forth. Under your regulations, these employees would be subject to tax on their use of these vehicles. Public Law 99-44 gave the IRS the authority to add certain vehicles to the list of exempted vehicles included in the conference report. Would you consider adding van and pickup trucks owned by a local government which are clearly marked with the name of the local government, and, therefore, highly unlikely to be used for personal purposes?

Mr. EGGER. I do not believe we have the authority to do that, Mr. Chairman. The specific vehicles which were included in the public law were very, very narrowly defined. Otherwise the statute only permits us to exempt law enforcement vehicles for the most part.

Senator ABDNOR. All right. The next one then deals with law enforcement. On November 6, 1985, IRS regulations exempted most police vehicles from the fringe benefit requirements of the law. One assumes this was done because of the emergency nature of such vehicles. Is there any reason why other local government vehicles which are also suitably marked as such and are used to respond to emergencies on a 24-hours-a-day basis should also not be exempted?

Mr. EGGER. Mr. Chairman, the answer is essentially the same. We are constrained by the statutory limitations insofar as the ones that can be exempt. There is a case to be made for so many vehicles in both the private and public sector that are people on call 24-hours-a-day, et cetera, and I feel certain that a lot of companies could make that argument. Certainly utility companies and people of that kind, the gas companies, and on and on and on.

And for whatever reason the Congress saw fit only to include the law enforcement agencies.

Senator ABDNOR. Very good. The hour is late, as I said. John, just think you have to keep doing this. The Commissioner is quitting so this is it. But we certainly do want to wish you well, Commissioner, and we are looking forward to seeing you, John, and the rest of you gentlemen.

ADDITIONAL COMMITTEE QUESTIONS

We have a number of written questions to submit to you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

TAX GAP

Senator ABDNOR: The Administration is proposing a significant tax collection effort in the FY 1987 budget to be continued in future years. First, what is the current tax gap? What impact will the initiative have on that gap? Is it realistic to assume the tax gap will ever be closed?

Mr. EGGER: Our latest projection of the income tax gap in FY 1987 is approximately $100 billion. We are now working on revised estimates, which will use the latest evidence from the Taxpayer Compliance Measurement Program (TCMP) for 1982 tax returns. The tax gap estimates will undoubtedly change, but we expect that the general magnitude will continue to show the tax gap to be a serious problem requiring increased attention.

In FY 1987, the Service will primarily address the income tax gap through the President's FY 1987-89 Revenue Initiative. This effort will add 2500 staff years to the Service's Examination program in each of the three fiscal years, maintain this increased level of staffing for two more years, and produce additional revenue collections of about $10 billion.

We have more closely examined the larger part of the income tax gap--the individual income tax gap--to determine how much of it is economical to close. We estimate that about 37 percent of the individual income tax gap could economically be closed with our current sources of information, if our enforcement programs were funded at their highest feasible levels. At current funding level we are closing about 11 to 15 percent of the individual income tax gap.

REVENUE MODEL FOR TAX ENFORCEMENT

SENATOR ABDNOR: For several years GAO has reported that IRS does not have the appropriate information systems to measure the additional revenues that would result from adding resources to each program in IRS.

What is IRS doing to improve its information in this regard?

MR. EGGER: The Service has steadily progressed in its efforts to accurately predict the effects that program changes have on enforcement revenues. We have now in place a working model which calculates all costs and benefits and flows the revenues produced on a cash basis for each fiscal year. Existing subsystems feed this model. The examination program has used a marginal yield model to predict examination yields since 1975. The collection and document matching programs have also developed models that will predict the effects that alternative resource levels have on revenue yields and yield to cost rates. These models are being tested and should be available for preparation and analysis of the FY 1988 budget.

In addition, the current working model is being expanded. When completed later this year, the model will simulate the marginal yield curves that are contained in the examination, collection and document matching functional models. It will allow the Service to quickly assess the impact that resource fluctuations have on enforcement revenues. The model will be able to provide maximized revenue strategies by allocating incremental resources to enforcement programs based on comparative marginal yields.

SENATOR ABDNOR: Considering the lack of information on marginal yields, how did IRS assess the impact of reducing resources from each of its programs, activities or projects to meet the Gramm-Rudman-Hollings Legislation targets?

MR. EGGER: As you know, the Service is requesting a supplemental that would ensure that the revenue forecast for FY 1986 is met. If this supplemental is approved, there would be no loss in enforcement revenue. However, if the supplemental is not approved, the Service would be forced to drastically reduce staffing in revenue-producing programs (examining tax returns, collecting unpaid taxes, securing delinquent returns and matching information returns) with a loss of over one billion dollars in revenue collected in FY 1986. These staff reductions would require furlough of experienced personnel on an across-the-board basis for varying amounts of time. As a result, all work in progress would cease, high yielding cases notwithstanding. Therefore, average yield per cost ratios for the enforcement revenue programs, which are readily available, were used to assess the impact of any reductions in FY 1986.

INTEGRATED DATA RETRIEVAL SYSTEM REPLACEMENT PLANS

SENATOR ABDNOR: You have recently experienced problems in computer acquisition. I am speaking about the Sysorex case. I will not reconstruct it, but I must say I am concerned about the impact this case will have on the IRS, as well as other agencies planning procurement actions. Could you briefly outline how you are handling the situation? What will be the budgetary impact?

MR. EGGER: The General Services Board of Contract Appeals (GSBCA) decision of January 23, 1986, ordered the Service to terminate the Computer Systems and Resources, Inc. (CS&R) contract for the equipment, known technically as Integrated Data Retrieval System (IDRS) Phase II. The Board's decision also offered the Service the choice of either awarding the contract to Sysorex Information Systems Inc. (the only offeror GSBCA found to be entitled to receive the award) or obtaining new Delegation of Procurement Authority and undertaking either a limited or full recompetition of the contract.

Based on the critical need to move ahead quickly with the replacement of the old unreliable terminals and the associated data communications processors, the Service awarded the contract to Sysorex on February 11, 1986. Under this contract, the installation of the replacement equipment will begin in 1986 and be completed by the end of 1987.

There are a number of reasons why the Service chose to accept this option from the GSBCA. These include:

- Fastest Improvement In Service to the Public

The IRS's objective to provide timely and quality service to the public cannot be met unless the old terminals and related data communications processors are replaced and additional terminals are acquired. Taxpayer Service alone has outstanding requests for approximately 900 additional terminals. The Sysorex contract provides the most expeditious way to meet this objective, with installation of a complete system at Atlanta by December 1986 and nationwide by the end of 1987. Furthermore, negotiations are currently underway to accelerate this schedule by installing three additional systems for our largest service centers, and remote terminals for all service centers, by the end of 1986. Limited recompetition would, at best, provide the needed systems by July 1989; full recompetition would delay nationwide implementation by an additional ten months beyond that.

- Reduced Impact on Mission-Sensitive Projects

The replacement of this equipment is a key element for major compliance, tax processing and taxpayer service projects such as the Automated Examination System (AES), the Automated Underreporter Program (AUP), Taxpayer Service Advanced Workstations (TSAWS), Integrated Collection System (ICS), Service Center Cost Accounting System (SCCAS), and the Integrated Management System (IMS). None of these cost beneficial projects can be implemented until the new equipment is in place.

- Fastest Replacement of Antiquated and Unreliable Terminals

The award of the Sysorex contract now permits the fastest possible replacement of the existing terminals, which are unreliable and difficult to maintain because of their age. Fast replacement will eliminate the extremely expensive maintenance cost associated with existing terminals (averaging over $270 per month for each of 4100 terminals, or $1,107,000 per month). The new terminals being procured under the Sysorex contract will cost $196 per month for each terminal, or $803,600 per month. Thus, IRS will save $303,400 each month under the Sysorex contract and will have the added benefit of using new, reliable computer terminals.

Another consideration was how much longer the current terminals, which were manufactured in the late 1960's and early 1970's could actually be maintained. The Service felt that the terminals would not be maintainable at any cost because of the lack of repair parts and components.

- Minimum Disruption to Service Center Processing

Sysorex's ability to replace all existing terminals immediately will minimize disruption to the Service Centers versus the necessity of replacing all the equipment (terminals and communications processors) at the same time. Once the replacement terminal network is stablized, the new communication processor can be installed parallel to the existing one, and a phased conversion would occur on a line-by-line basis. If problems develop, the terminal lines could be reconnected to the existing processor until the problem is resolved.

The Sysorex contract will cost $42 million more than the original CS&R contract would have cost us over the seven years system's life. This figure represents total costs in discounted dollars and assumes that all optional quantities will be exercised during the term of the contract. The additional cost of the Sysorex contract will be offset to a great degree by the savings in maintenance costs related to the current CDC terminals and Sperry communications processors.

Senator ABDNOR: And finally, how do we insure that this sort of thing doesn't happen in the future?

Mr. EGGER: In the Sysorex case, a problem occurred in the evaluation of pricing proposals. The GSBCA did not find fault with the procedures by which the price evaluations were to be conducted, but there were serious errors made. Price evaluations are complicated, involve a number of steps, and, up to this point, have been done manually. To ensure we do a better job, we are adding staff, including a cost/price analyst to provide expertise in conducting price analyses and reviews of price evaluations. In addition, the format for submitting pricing information has been simplified and computer programs are being developed to process the pricing data submitted.

The procurement process is complex. It is impossible to eliminate all errors on the part of the vendor community and/or the Government, but the steps we are taking to simplify, automate, and increase staff will minimize the potential.

PAYMENT OF INTEREST

SENATOR ABDNOR: In an effort to keep interest costs down during the 1985 tax filing season, IRS attempted to process returns involving refunds of $1,500 or more first. Is IRS again planning to give preferential processing to large dollar refunds? If not, what is IRS' current policy?

MR. EGGER: Our policy of manually refunding amounts of $1,500 or more, when interest free period is in jeopardy, was rescinded on December 11, 1985. Our new policy authorizes manual refunds only for hardship cases, for systemic limitations, and those cases where IRS action has caused a gross disservice to the taxpayer. Hardship situations would include refunds from disaster claims and instances where the refund needs to be expedited to prevent foreclosure or bankruptcy. Systemic limitations include deceased taxpayers where the refund needs to be issued to a surviving spouse or executor, and refunds of $1 million or more which the computer is incapable of issuing. Gross disservice includes any situation where IRS errors have caused a gross delay in the taxpayer receiving a refund.

SENATOR ABDNOR: Should IRS be granted additional time, beyond the current 45 day interest-free period it now has, to process returns interest free? If so, why? Has IRS developed estimates on how much interest could be saved if the interest free period were extended?

MR. EGGER: In my statement before the House Ways and Means Committee on June 21, 1985, I reported that the amount of additional interest paid from the end of the 45 day interest-free period (May 30) to the 60th day (June 13) in 1984 was $6,855,000, and in 1985 was $5,985,000. These amounts would be the approximate savings in interest paid, were the interest free period 60 days rather than 45 days.

However, payment of interest on timely filed returns will never be completely eliminated due to the peak receipts during the last weeks of the filing season, delays due to incorrect returns, and to enforcement actions necessary for some returns. However, interest on these returns constitutes only a small portion of the interest we pay during that 15-day period.

SENATOR ABDNOR: Has IRS developed any legislative initiatives to reduce the amount of interest paid on refunds? If so, please describe.

MR. EGGER: We have prepared proposals for Treasury consideration which would reduce interest paid out. These include a proposal to extend the interest-free period from 45 days to 60 days and a proposal to extend the interest treatment of income tax to all other types of tax.

COLLECTION ACTIVITES - DELINQUENT TAXES

Senator ABDNOR: During the Fiscal Year 1986 Appropriations Hearings, IRS stated that, at the end of Fiscal Year 1984, the amount of delinquent taxes owed the Federal government totaled $29.4 billion. This figure is composed of various delinquency categories, including accounts in notice status, accounts being actively worked by IRS Collection personnel, accounts classified as "Currently Not Collectible", accounts being paid through installments, and accounts not being actively worked because of dollar tolerance levels and other reasons. During the Fiscal Year 1986 appropriations hearing, IRS mentioned that while the total delinquency balance is expected to increase, it intends to reduce the number of accounts in active inventory and collect more money.

What was the outstanding delinquency balance at the end of Fiscal Year 1985? What is the breakdown of this figure by the various delinquency categories? How many accounts are in each category?

Mr. EGGER: Before I provide the specific numbers, I do want to advise you that for FY 1985 the Service revised our reporting of accounts receivable to make it consistent with private industry accounting practices. For purpose of comparison between years, you must look at total accounts receivable.

At the end of fiscal year 1985 there were $43.5 billion in delinquent taxes owed to the government. The total amount is composed of accounts in the following categories:

ACCOUNTS RECEIVABLE
Fiscal Year 1985

Category	Number (000's)	Amount
Notices	N/A	$12.7 billion
Active TDAs	1,692	9.1 billion
Installments Agreements	546	.7 billion
Currently Not Collectible	3,002	7.6 billion
Deferred	2,209	.3 billion
Other System Monitored (e.g. Bankruptcy, litigation)	N/A	4.9 billion
TOTAL Delinquent Accounts Reveivable -		$35.3 billion
Current Accounts Receivable -		$ 8.2 billion
Total Accounts Receivable -		$43.5 billion

Senator ABDNOR: How do these Fiscal Year 1985 delinquency numbers and amounts compare to the inventory of the various delinquency categories at the end of Fiscal Year 1984? At the end of Fiscal Year 1980?

Mr. EGGER: The total delinquent accounts receivable were $15.6 billion FY 1980 and $29.4 billion in 1984. The breakout by category is:

ACCOUNTS RECEIVABLE
Fiscal Year 1984

Category	Number (000's)	Amount
Notices	N/A	$ 8.8 billion
Active TDAs	1,934	8.5 billion
Installment Agreements	598	.7 billion
Currently Not Collectible	2,441	6.2 billion
Deferred	2,391	.3 billion
Other System Monitored (e.g. Bankruptcy, litigation)	N/A	4.9 billion
TOTAL Delinquent Accounts Receivable -		$29.4 billion
Current Accounts Receivable -		$ .7 billion
Total Accounts Receivable -		$30.1 billion

ACCOUNTS RECEIVABLE
Fiscal Year 1980

Category	Number (000's)	Amount
Notices	N/A	$ 3.2 billion
Active TDAs	1,204	3.6 billion
Installment Agreements	438	.4 billion
Currently Not Collectible	1,645	3.5 billion
Deferred	1,724	.2 billion
Other System Monitored	N/A	4.9 billion
TOTAL Accounts Receivable		$15.8 billion

Senator ABDNOR: What does IRS need to do to reduce the numbers and amounts of delinquency inventories?

Mr. EGGER: We are seriously concerned about the continued growth in the amount of outstanding accounts receivable. The 4,000 staff year revenue initiative authorized by Congress in 1983 has been concentrated in the active TDA area allowing us to reduce active field inventory and stabilize the dollar amount of that inventory.

The majority of growth in recent years has been in the notice category, one area where we are limited in steps we can take to increase taxpayer responsiveness. Some of this growth is the result of delays in issuing notices that we implemented to ensure taxpayers would not be adversely impacted by last year's tax processing delays.

The current accounts category in FY 84 and prior totaled under $1 billion. The FY 1985 increase to $8.2 billion is attributable in part to the last year's processing delays and our decision to delay notice issuance until we were sure we were issuing correct notices. We expect this balance to drop later in the year as we make further progress in reducing backlogs resulting from last year's processing problems.

Collection is also pursuing several additional efforts to reduce delinquencies:

- improving use of information documents in identifying delinquent taxpayers
- increased automation efforts for contacting and assisting taxpayers and accessing third party information.
- varying the notice process based on taxpayer characteristics to improve taxpayer response;
- reviewing the quality of our notices, steps we take in processing the notices, and taxpayer responsiveness to further improve our processing.

REVENUE COLLECTIONS

Senator ABDNOR: How much in delinquent taxes was collected during Fiscal Year 1985? What did it cost IRS to collect these delinquent taxes?

How does the cost to collection ratio for Fiscal Year 1985 compare to the prior 5 Fiscal Years? To what does IRS attribute any change in this ratio?

Mr. EGGER: Revenue collections for FY 1985 totaled $18.3 billion, up 11.5% from $16.4 billion in FY 1984. The cost to collect these revenues totaled about $472 million.

For FY 1985, Collection returned about $20 for every dollar spent. Since 1980, Collection has consistently returned between $20 to $24 dollars for each dollar spent on revenue collections.

AUTOMATED COLLECTION SYSTEM

Senator ABDNOR: Over the past few years, IRS budget and plans have called for significant improvements in collecting delinquent taxes through automation. The first major automation project was the Automated Collection System (ACS), which automated the former Collection Office function. ACS was fully implemented in June, 1984. During the Fiscal Year 1986 appropriations hearings, IRS mentioned that the Special Procedures function would be automated in Fiscal Year 1985 and that IRS would start automating the Collection Field function in Fiscal Year 1986.

With over one full year of ACS operations, can IRS provide us with information on the cost savings and increased collections attributed to ACS?

How do the collection results of ACS compare to the collection results of the former Collection Office function?

Does IRS have any plans to alter or improve ACS in the future? If so, what specifically is planned?

Mr. EGGER: We are extremely pleased with the operation of our ACS sites which provide state-of-the-art computer and telephone technology for improving collection operations. ACS was Collection's initial automation project and has proved very successful in speeding up revenue collections and controlling workload. Like any new system, we are continuing to make operational improvements that will enhance our ability to locate and deal with taxpayers.

For FY 1985 the first full year of its operation, revenue collection for ACS totaled $2.3 billion, up 45% over FY 82 COf levels and 17% over our FY 83 COf levels. This was accomplished with 1700 fewer staff years at a total savings annually of $32 million.

We are currently working on an integrated system that will link ACS and the remaining Collection operations under one automated system. These efforts are described fully in the response to the following question.

AUTOMATION

Senator ABDNOR: Has the automation of Special Procedures functions been completed? Has IRS realized any savings or increased collections based on this automation?

What is the status of the proposed automation of the Collection Field function. When does IRS expect this automation to be completed?

Mr. EGGER: During FY 1985 we began development of the Integrated Collection System (ICS) for automating the remaining Collection activities which includes the Collection Field and Special Procedures function and the Collection operations in the Service Centers. ICS will integrate all our automation efforts, including ACS, under one system and will permit Collection employees direct access to a taxpayer's account and result in improved case processing and taxpayer relations. Development will continue through FY 86 and 87 with nationwide implementation of this integrated system completed by early FY 89.

We have issued a number of short-term automation programs to our Special Procedures and Collection Field functions that have produced immediate productivity gains. We expect to realize significant additional productivity gains from ICS and plan to finance the ICS operation with these productivity savings. ICS will permit us to speed up collection of more than $2 billion over the life of the system with reduced staffing.

WALK-IN SERVICE

SENATOR ABDNOR: According to the fiscal year 1986 House Appropriations hearings record, IRS between fiscal years 1981 and 1983 reduced the number of its walk-in offices by 43 percent, from 829 to 472. As an alternative to walk-in assistance, IRS expanded its Outreach program in 1984. IRS assisted 385,000 taxpayers through this program in fiscal year 1984 and anticipated the same number of taxpayers would receive assistance from the program in both fiscal years 1985 and 1986.

Since last year's hearings, has IRS made any studies comparing the costs of providing return preparation assistance outside of normal business hours through the Outreach program to the costs providing similar assistance during normal business hours at its walk-in offices?

MR. EGGER: The Service prepares a "cost-per-contact" analysis for its taxpayer assistance activities each year. In FY 1984, the cost per Community Outreach Tax Assistance contact was $6.22; the cost per walk-in office contact was $2.32.

It should be noted, however, that the assistance provided at an Outreach session is often very different from the assistance provided in an IRS walk-in office. The help we provide in our offices includes answering specific tax questions and assisting taxpayers with IRS notice-related questions; we prepare very few tax returns--only for the handicapped or those physically unable to prepare their own returns. Most contacts are brief.

Outreach, on the other hand, emphasizes group tax assistance at either return preparation seminars or sessions where taxpayers listen to presentations on new tax laws or on a tax issue of interest. Generally, Outreach sessions are considerably longer than the time it takes for a taxpayer to be assisted in an IRS office. Travel and overtime expenses also help to account for the disparity in the Outreach and walk-in costs-per-contact.

SENATOR ABDNOR: To what extent did the 1985 Outreach program service geographical areas where IRS closed walk-in offices between 1981 and 1983?

MR. EGGER: Our field offices are directed to offer Community Outreach Tax Assistance sessions in areas where taxpayers were once served by the IRS, but where offices are now closed. In addition, we encourage Outreach sessions where taxpayers cannot get or have difficulty getting taxpayer assistance during regular IRS business hours and in areas not served by our Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs.

SENATOR ABDNOR: Do taxpayers assisted by the Outreach program fit the same income, education, and age profiles as taxpayers previously assisted at the closed walk-in offices?

MR. EGGER: The Service does not maintain a record of the incomes, educations, or ages of those who attend Community Outreach Tax Assistance sessions or those who seek tax help in our walk-in offices. As a result, we have no way of comparing the profiles of those served by Outreach and those once served by IRS offices.

TELEPHONE SERVICE

SENATOR ABDNOR: During the 18-week period from the beginning of May to early September 1985, IRS responded to about 600,000 more telephone calls than it did during the same period of 1984. The number of telephone calls that went unanswered also increased -- from 13.6 million in 1984 to 47 million in 1985.

What has IRS done and what is it planning to do to prevent a recurrence of those telephone-related problems in 1986? Could you provide some specifics, such as the number of additional phone lines and additional staff to handle calls for the record?

MR. EGGER: For FY 1986, the number of telephone lines available for tax assistance has increased 11 percent from 3,036 circuits in 1985 to 3,372 circuits in 1986. Staffing has also been increased.

Multifunctional equipment (MFE)--providing recorded tax and refund information--was expanded from 26 systems (21 systems with 25 lines each and 5 systems with 50 lines each) to 32 systems with 50 lines each. The additional systems were used to create 2 new sites (Pittsburgh and Richmond) and gave 4 existing sites (Chicago, Brooklyn, Houston, and Dallas) 100 line capacity. This increased the overall circuitry from 718 lines in FY 1985 to 1,504 lines in

FY 1986. The expansion was operational in 26 sites in January and 1 site (Dallas) in February.

In addition, nationwide toll-free service for MFE was implemented for the first time in January 1986. In 1985, taxpayers calling the MFE system from certain areas were charged for those calls.

A high performance Automatic Call Handler (ACH) upgrade has been developed for the Multifunctional Voice Response System now installed in 26 IRS locations. This improvement will reduce the transaction time per call, allowing additional calls to be answered. It will also give rotary callers equal access to the telephone system, give taxpayers more information about their refunds, and provide us with more management information.

SENATOR ABDNOR: What level of calls is IRS expecting to receive this filing season and what level of calls is IRS staffed to handle?

MR. EGGER: The Service projects that it will receive about 28 million telephone calls for tax assistance during the filing period. We are staffed to handle approximately 22 million taxpayers through the telephone operation.

SENATOR ABDNOR: What are the chances that a taxpayer will reach IRS on his/her first call this filing season?

MR. EGGER: Our weekly survey of toll-free telephone calls indicates that about 76% of taxpayers that reach us for assistance are doing so on the first call.

In an effort to use our resources wisely, we continually adjust the number of telephone circuits we use for tax assistance and the number of employees answering calls from taxpayers. At times, the number of calls we receive exceeds the number of available circuits and telephone assistors; at those times taxpayers receive a busy signal. Because we have increased the number of incoming lines and employees this filing season, we expect that callers will reach us on the first call more often this year.

We have continued to encourage taxpayers to call us for assistance early in the day or at the end of the week. The demand for service is usually lower at these times, and taxpayers then have the best chance of reaching us with one call.

SENATOR ABDNOR: In 1985, according to some newspaper accounts, the volume of calls in Philadelphia almost toppled the entire phone network in the city of Philadelphia.

To what extent has IRS taken action to avoid a similar problem this year?

MR. EGGER: The Philadelphia answering site increased the number of telephone lines by 25.7 percent (70 in 1985, 88 in 1986) over last year's filing period. Also, since our returns processing system has implemented safeguards this year, there is less chance that we will experience the problems we faced in that area in 1985, thus reducing the number of inquiries caused by processing delays.

SENATOR ABDNOR: How flexible is IRS' phone service plan in Philadelphia should processing problems occur again; for example, to what extent can phone service be expanded?

MR. EGGER: The phone system in Philadelphia has the capacity to expand another 13.6 percent (12 lines) over its current number of lines. Additional local lines require about three to five days for installation; additional intrastate WATS lines require 13 to 25 work days for installation. Expedite service by the telephone companies involved could reduce these time frames. Contingency plans have been made to recruit personnel from other functions to staff the additional lines.

STAGGERED FILING

Senator ABDNOR: In fiscal year 1985, IRS experienced considerable difficulty in processing returns timely, resulting in late refunds for many taxpayers. This year may prove to be an even more difficult one since IRS estimated in the fiscal year 1986 that it would process 5 million more returns than it did in fiscal year 1985.

As a means to prevent return processing backlogs and to ~~get refunds~~ out in a timely manner, has IRS studied the costs and benefits to the federal government of a staggered filing season? If so, what were the results? And, why hasn't the federal government adopted such a system.

Mr. EGGER: Some years ago, IRS studied alternative filing date proposals and concluded that the existing system was preferable for the private sector, the IRS and the public in general. The IRS, in conjunction with the Treasury Department, is currently updating this 1977 report. The current study focuses on a proposal to stagger individual income tax filings by date of birth. Other possibilities being analyzed include staggering filing dates by social security numbers.

As part of the current study, a survey of taxpayers' views on staggered filing was conducted. The results were only received recently and have not been fully analyzed. However, the summary found that most taxpayers say they will not take advantage of the staggered option, if offered. Complete results of the survey will be incorporated in the Service's report.

Senator ABDNOR: What would be the impact of a staggered filing season on the private sector?

Mr. EGGER: The current staggered filing proposals being analyzed should not materially change employer responsibilities since no change is being made to the taxpayer's accounting period; only the reporting period would be affected. Therefore, private sector costs should not be significantly affected. Our review will concentrate on operational and other costs or benefits to IRS and Treasury.

ABUSIVE TAX SHELTERS

IDENTIFICATION OF ABUSIVE TAX SHELTERS

SENATOR ABDNOR: Abusive tax shelters are usually investment promotions that lack economic purpose other than the generation of tax benefits and constitute an abuse of the tax laws. The detection of abusive tax shelters is one of the Internal Revenue Service's (IRS) top priorities. IRS identifies abusive shelters primarily through its examination of taxpayer returns containing tax shelter issues in general and through tax shelter registration data provided by promoters. IRS has instituted an enforcement program to deal with promoters of abusive tax shelters. In recent years, the Congress has sought to enhance IRS enforcement efforts against promoters through the addition of compliance tools in the Tax Equity and Fiscal Responsibility Act of 1982 and Deficit Reduction Act of 1984.

IRS estimates that there was a backlog of 382,000 taxpayer returns containing tax shelter issues, in general, in the examination process as of June 30, 1985--an increase of 45,000 from the end of 1984. The effectiveness of efforts to reduce the backlog depends on the timeliness of IRS decisions regarding whether an investment promotion involves the sale of an abusive shelter. In 1985, IRS identified 25 investment promotions as being abusive, which accounted for 44,700 taxpayer returns in the backlog.

What is the IRS' criteria for determining whether an investment promotion lacks economic purpose, i.e., is it an abusive tax shelter?

MR. EGGER: An abusive tax shelter promotion is one that utilizes improper or extreme interpretations of the law or the facts to secure for investors substantial tax benefits which are clearly disproportionate to the economic reality of the transaction. The criteria used to identify an abusive tax shelter are: overvalued assets; false or fraudulent statements; and lack of profit potential. Examples of the principle characteristics associated with abusive tax shelters include: large net loss; large amount of investment tax credits; negative capital account in an investment and; use of non-resource or contingent financing.

SENATOR ABDNOR: What factors contribute to the long time required for IRS to determine that the investment promotions identified in the backlog of taxpayer returns involve the sale of abusive shelters?

MR. EGGER: Tax shelter promoters are generally uncooperative in responding to examiner requests for books, records, or testimony. This lack of cooperation leads to the issuance of summons and possible summons enforcement. Most examinations require third party interviews and appraisals of the asset in question. In a significant number of cases, promoters fragment business activities so the books and records and the asset in question are not in the same geographical area. We also have identified instances where abusive tax shelters have been organized in tax haven countries.

SENATOR ABDNOR: At what organizational level in IRS is the official determination made that a specific investment promotion involves an abusive tax shelter?

MR. EGGER: Potential abusive promotions are sent to a district screening committee made up of district managers and a representative of district counsel. If the committee believes a promotion is abusive, it is assigned for examination to a revenue agent and a district counsel attorney. The revenue agent and district counsel attorney will contact the promoter, request books and records to review, and make a determination if the promotion is abusive.

SENATOR ABDNOR: Once it is determined that an investment promotion involves an abusive shelter, to what extent is the initial determination subject to higher level review?

MR. EGGER: If the case involves a promoter penalty, pre-filing notification letter to the investors, or an injunctive action against a promoter, the case is further reviewed and approved by the District Director with the advice of District Counsel. Pre-refund cases, because of their sensitivity, require additional levels of review and are approved by the Assistant Commissioner (Examination).

In injunctive cases the Department of Justice makes the final determination as to the injunctive potential before petitioning the District Court.

SENATOR ABDNOR: What procedures are used to disseminate Service-wide a determination that an investment promotion involves an abusive shelter?

MR. EGGER: We have a Management Information System consisting of several programs used in identifying, tracking and disseminating results of examinations to appropriate Service personnel. The information is disseminated through monthly hard copy reports. Additionally, access to the data is available through the use of computer terminals.

SENATOR ABDNOR: What factors have contributed to the June 1985 backlog of 382,000 taxpayer returns involving tax shelter issues?

MR. EGGER: In addition to the factors noted earlier, such as uncooperative promoters, summonses, and promotions and investors in different geographical areas, multiple investments by taxpayers also have caused the backlog to increase. Promoters in many instances, also structure the promotion so that the proposed deductions/ credits are reported on the investors' individual returns on Schedule C (Profit or (Loss) from Business or Profession).

The absence of a partnership return in these cases has made the identification of an abusive tax shelter promotion more difficult. Taxpayers have continued to invest in abusive shelters which, when detected by our front-end identification programs, have added to our existing inventories.

During FY 1985, Examination closed over 141,000 returns resulting in additional recommended tax and penalties of over $2.5 billion. We have made tax shelters one of our highest priorities.

SENATOR ABDNOR: What was the backlog of taxpayer returns involving shelter issues as of December 31, 1985? How many of the returns in the backlog have been determined to involve abusive tax shelters? For each category of returns identify the number of (a) investment promotions and (b) partnerships.

MR. EGGER: Our tax shelter inventory as of December 1985 is 413,700 returns. The number of returns which are being examined or in the process of being closed as abusive tax shelters is 353,700 returns. The balance of the inventory (60,000) are in the process of being reviewed for audit potential.

The inventory consists of flow-through entities (i.e., partnership returns) and their related investors. We currently have approximately 38,000 flow-through entities of which 30,000 are partnership returns. Not included in our inventory figures are 1,200 examinations in process to determine if promoter penalties, injunctive relief, or pre-filing notification letters are appropriate.

"OUT-OF-POCKET EXPENSES" POLICY

SENATOR ABDNOR: In an effort to administratively dispose of the backlog of tax shelter cases, IRS adopted a policy effective August 23, 1982, of allowing "out-of-pocket expenses" (cash investment) as a deduction if the taxpayer would agree to settle the case. The policy is not applicable to post-1980 returns. IRS, in November 1984, implemented a selected withdrawal of "out-of-pocket expenses" for pre-1981 tax shelter cases that had not been settled and would involve minimal litigating hazards.

In order to reduce the backlog of pre-1981 returns containing tax shelter issues, IRS offered certain taxpayers their "out-of-pocket expenses" as a deduction in the initial year of the investment as an inducement to settle the case.

To what extent had IRS made a determination service-wide that each investment promotion involved in the "out-of-pocket expenses" offer was an abusive tax shelter?

MR. EGGER: The Service-wide position is that we will only allow out-of-pocket settlements in pre-1981 abusive tax shelters. The exception to this general rule is that out-of-pocket settlements will not be allowed in litigating vehicles and criminal investigation cases.

SENATOR ABDNOR: What is the legality and IRS' rationale for the "out-of-pocket expenses" policy?

MR. EGGER: The out-of-pocket settlement policy was adopted after consideration of five factors: (1) the size of the pre-1981 shelter inventory, which was roughly half of all pending nondocketed cases; (2) the minimal precedential value of these "old" cases; (3) the Service's resource constraints; (4) the need to focus on more current tax shelter abuses; and (5) the imposition of penalties for overvaluation and substantial understatement for 1981 and subsequent tax years. It was also recognized that there were some litigation hazards in these cases based on various theories. The administrative compromise of the out-of-pockets settlement was seen as a tool to reduce tax shelter inventory.

The Service has long exercised its authority at the Appeals level to resolve issues based upon a hazards-of-litigation analysis. The out-of-pocket settlement policy merely extended to Examination the authority to settle these cases on a uniform basis. The out-of-pocket settlement policy also recognizes a certain degree of fairness by allowing each taxpayer only to deduct the cash investment.

SENATOR ABDNOR: The Tax Court often holds that taxpayers are not entitled to their "out-of-pocket expenses". Therefore, to what extent is IRS considering changing its "out-of-pocket expenses" policy for pre-1981 returns when the taxpayer has not been advised that the "out-of-pocket" offer could be withdrawn?

MR. EGGER: The IRS periodically reviews its out-of-pocket settlement position with respect to individual shelters. If the IRS litigates a specific shelter and obtains a decision on the merits, we will review and modify our settlement position in light of the Court's decision. Those taxpayers, who have not previously resolved their cases, will be advised of the modified settlement position. In addition, taxpayers are frequently advised that an out-of-pocket settlement offer or any other settlement offer has a deadline for acceptance. If a taxpayer rejects an out-of-pocket settlement offer, that settlement offer is usually not reoffered to the taxpayer.

SENATOR ABDNOR: Since the "out-of-pocket expenses" policy applies only to pre-1981 returns, how does this provide for equitable treatment of taxpayers with similar tax shelter issues on post-1980 returns?

MR. EGGER: A factor in adopting the out-of-pocket settlement policy was the enactment of penalties, such as the overvaluation penalty of section 6659 and the substantial understatement penalty of section 6661, which were applicable to 1981 and subsequent taxable years. It was thought that enactment of these penalties would have a beneficial effect on tax compliance and justified distinguishing between shelters by year of investment rather than by type of investment. To the extent that the out-of-pocket settlement policy applies, it is available uniformly to pre-1981 taxpayers (other than litigating vehicles and criminal cases) and is not available to post-1980 taxpayers.

SENATOR ABDNOR: What is IRS' policy regarding the settlement of post-1980 returns involving abusive tax shelter issues?

MR. EGGER: Post-1980 returns involving tax shelter issues may be resolved, as any other issue, at the Examination level based upon a facts-and-circumstances analysis of the shelter issues. Out-of-pocket settlement offers are not available for post-1980 returns. Appeals and Counsel may settle post-1980 shelter cases on a hazards-of-litigation basis as they would resolve any other case.

SENATOR ABDNOR: Doesn't the "out-of-pocket expenses" offer conflict with the Service's position that aggressive action should be taken against abusive tax shelter deductions?

MR. EGGER: The short answer is that to a limited extent there is a conflict. The out-of-pocket offer was a tool in the Service's efforts to reduce the inventory of docketed and nondocketed shelter cases as well as publicly stating to taxpayers that the so-called "investments" would not yield the purported tax benefits and economic benefits.

However, it should be noted that, even when a cash out-of-pocket settlement offer is made, it results in a substantial disallowance of claimed shelter losses, unless the investment was in a straight 1:1 deal. The amount of loss allowed depends upon the actual cash invested. For instance, someone who invested in an abusive 10:1 write-off only receives ten cents on each dollar "invested." In addition, if the Service litigates a shelter and prevails on the merits, the out-of-pocket offer is withdrawn, and the Service now looks to the hazards of litigation in resolving and settling taxpayer cases. Finally, few investors in such shelters would consider out-of-pocket settlements a windfall to them.

SENATOR ABDNOR: IRS' position on the selected withdrawal of "out-of-pocket expenses," involving at least 44,700 returns, was that the tax shelter issues could be resolved with minimal hazards of litigation.

Why didn't IRS proceed with litigation procedures?

MR. EGGER: In recent years, IRS has tried numerous tax shelters which have settled the case law with respect to many types of shelters. It is neither economically feasible for the IRS nor practicable for the Tax Court to try all of the docketed shelters. Now that the case law is established in many areas, we are increasingly resolving these cases through the litigation process. Aggressive, selective litigation and withdrawal of out-of-pocket settlement offers are proving successful.

SENATOR ABDNOR: What amount of potential taxes was lost by IRS' making the (1) "out-of-pocket expenses" offer and (2) "selected withdrawal of out-of-pocket expenses" offer, rather than having the disallowances on the taxpayer returns sustained through settlements and/or litigation procedures?

MR. EGGER: We do not have any precise figures available regarding the potential taxes "lost" by the out-of-pocket settlement policy. However, we note that in all unagreed cases, whether shelter or nonshelter, the amounts in dispute are subject to compromise by Appeals and Counsel. In our opinion, extension of settlement authority to Examination through the out-of-pocket settlement policy did not result in a significant loss of potential taxes had the cases been handled in the normal manner.

TAX SHELTER REGISTRATION PROGRAM

SENATOR ABDNOR: Under the Deficit Reduction Act of 1984, certain tax shelter promoters are required to register their shelters with IRS.

How many shelters have been registered with IRS?

MR. EGGER: The service has issued 22,155 registration numbers since the inception of the program in October 1984. During the 4 months ended January 31, 1986, 4,315 registration numbers were assigned as compared to 17,840 in FY 1985. However, it should be noted that during the first 3 months of the program, there were 6,721 applications filed under the requirements of the first revision of the temporary regulations which were broader in scope than the current regulations.

SENATOR ABDNOR: To what extent has IRS found that shelter promoters are not registering?

MR. EGGER: While we have found instances where promoters have failed to register, the extent of the problem is unknown at this time. This is due to the newness of this program. We have instituted a tracking system which will capture the requested information in the future.

SENATOR ABDNOR: How does IRS use registration information in its program to curtail the sale of abusive tax shelters?

MR. EGGER: Tax shelter registration information from the application is distributed on a monthly basis to all districts, service centers and regional offices. We have found that, in the short time the program has been in existence, registration information has been extremely beneficial in our efforts to timely identify and examine abusive promotions. For example, application information:

(A) supports our injunction activities by proving the existence of current activities of promoters already under examination.

(B) allows district tax shelter coordinators to keep abreast of tax shelter promotions within their districts.

(C) is used by our Abusive Tax Shelter Detection Teams in each service center to detect and identify potentially abusive promotions.

SENATOR ABDNOR: To what extent has the information proven to be useful to IRS in the early detection of abusive tax shelters?

MR. EGGER: The feedback we have received from our field personnel indicates to us that the registration information has been very useful to the shelter program. For example, in one region, 38 separate tax shelter penalty examinations were initiated or enhanced by the appropriate use of registration information. As this program is relatively new, we expect results to substantially increase during the coming year.

TAX SHELTER PENALTY AND INJUNCTION PROVISIONS

SENATOR ABDNOR: The Tax Equity and Fiscal Responsibility Act of 1982 provided IRS with promoter penalty and injunction tools to help IRS deter abusive shelters.

Have the tax shelter promoter penalty and injunction provisions of the Tax Equity and Fiscal Responsibility Act of 1982 helped IRS reduce the number of abusive shelters being sold?

MR. EGGER: Since the inception of TEFRA, we have completed 262 promoter cases, assessed promoter penalties of $79,168,000 and enjoined 71 promoters from further tax shelter activity. The professional community and various periodicals have all indicated that our activities have resulted in a decline in the number of abusive promotions being sold. We do not feel, however, that we have resolved the tax shelter problem.

As the promoters have become familiar with the new law, they have found ways to frustrate our efforts. For example, promoters are using offshore promotions, creative financing, and instructing their clients to hide deductions on their returns by misclassifying them.

SENATOR ABDNOR: Does IRS have any new initiatives or proposed legislation under consideration to combat abusive tax shelters?

MR. EGGER: At present, we do not have any proposed legislation. Sufficient time has not elapsed to fully assess the impact of the Tax Equity and Fiscal Responsibility Act (TEFRA), Economic Recovery Tax Act (ERTA), and Deficit Reduction Act of 1984.

Also, H.R. 3838, which is pending will have a significant impact on tax shelter promotions. Before new legislation is proposed, we will need to assess the impact of the bill in its final form.

A new initiative being formulated is the use of Nationally Coordinated Projects. The Nationally Coordinated Project approach will assure that all IRS functions take coordinated expeditious and effective action to address the area of noncompliance. This will help deter further abusive tax shelter promotion activity by the coordinated assertion of penalties against all persons responsible for organizing, promoting/selling, marketing, and/or aiding/abetting the abusive activity.

The new Partnership Control System (PCS) is designed to control an unlimited number of investors in Abusive Tax Shelter Cases. The system also will not allow the closing of an investor return without first completing the examination of all related flow-through entities. Updates to PCS of new information will be available nationwide on a weekly basis.

SENATOR ABDNOR: In the Mid-South Music Corp. (DC Tenn., 9782) case, IRS was found to have violated tax return information disclosure laws by issuing prefiling notification letters to investors in a tax shelter scheme.

What is the status of that case?

MR. EGGER: On December 27, 1985, the Solicitor General authorized prosecution of an appeal in Mid-South Music Corp. v. U.S. to the United States Court of Appeals for the Sixth Circuit. On March 14, 1986, the Government filed its brief in support of its appeal.

SENATOR ABDNOR: Are there other similar or related cases pending? If so, how many?

MR. EGGER: Other than Mid-South Music Corp., there are no cases currently pending involving challenges to alleged disclosures contained in prefiling notification letters. While not specifically involving prefiling notification letters, three pending cases are challenging alleged improper disclosures of information contained in written communications by the Service with investors in tax shelter promotions.

Four other cases which challenged prefiling notification letters either from a constitutional or disclosure standpoint have been resolved -- one was dismissed with prejudice by agreement of the parties, two were dismissed, and the third upheld the constitutionality of such letters.

SENATOR ABDNOR:	Have there been any changes in IRS' policies and procedures for issuing a prefiling notification?
MR. EGGER:	There have been no changes in IRS' policies and procedures for issuing a prefiling notification. We do not view the Mid-South case as a bar to further issuance of prefiling notifications and are continuing to recommend that they be a part of the "front-end" approach to tax shelters.

CIVIL PENALTIES

SENATOR ABDNOR: IRS regulations save employers from having to pay a penalty if they make timely deposits of at least 95 percent of their withheld income tax and social security liability. This so-called "safe haven" rule is intended to relieve employers from paying a penalty if they cannot determine their actual liability in time to make deposits within the required 3 banking days after the end of the liability period. However, IRS regulations do not preclude employers from using the rule even if they can determine their actual liability. Therefore, employers can take advantage of this situation by delaying deposits of up to 5 percent of their tax liability for a period of up to 56 days. Last year IRS indicated that it was studying whether it should publish regulations that would accelerate deposits of the "safe haven" amount. IRS further indicated that the study would be completed in 1985.

Has IRS' study been completed and, if so, does IRS plan to adopt new regulations that would close up the "safe haven" loophole?

MR. EGGER: The 95 percent safe-haven was originally promulgated to enable employers to deposit substantially all taxes within three business days without being subject to the penalty for underdeposits caused by many employers' inability to determine with 100 percent accuracy within three days (really two and a half days since many banks required FTDs to be submitted by 2 p.m.) the amount required to be deposited. It appears from the IRS study that about half the eighth-monthly depositors are unable to determine with complete accuracy the amount to be deposited and thus need the 5 percent margin of error provided by the 95 percent safe-haven. We recognize that a number of large employers have sophisticated payroll information systems available which enable them to deposit exactly 95 percent of the taxes due, but it is infeasible for the Service to determine which employers should be permitted to use the 95 percent safe-haven and which ones do not need it.

It was the judgment of the Treasury and Service personnel who prepared the regulations that although narrowing the deposit safe-haven from 90 percent to the present 95 percent achieved a better balance between the benefits of faster deposits and the burdens thereof, tightening the safe-haven further, or requiring faster payments of the underdeposited amounts, would impose excessive burdens upon employers and payors in comparison to the benefits that would accrue to the Treasury.

Senator ABDNOR: One purpose of civil penalties is to provide an incentive for compliance. What studies has IRS conducted to determine the effect of the various penalties on compliance?

Mr. EGGER: We have begun a study of penalties under our Strategic Plan. For this study, we are assembling detailed data concerning the kinds of penalties imposed on taxpayers with various levels and types of income and deductions. With this information, we hope to be able to form some conclusions concerning the effectiveness of the current penalty structure.

SENATOR ABDNOR: Should the various civil penalties be increased to cover IRS' cost of asserting the penalty and to enhance compliance?

MR. EGGER: With one exception, I do not believe there is any need to further increase civil penalties at this time. Many new penalties have been added to the Code and old ones substantially increased by recently enacted tax laws. The vast majority of penalties are now large enough to cover the cost of collection. Until the IRS has an opportunity to evaluate the impact of these recent changes on compliance, further increases are not desirable.

The one exception concerns the failure to pay penalty. It is recommended that this penalty be increased from one-half of one percent of the amount due per month (up to 25 percent) to one percent per month (up to 25 percent) after the taxpayer has been notified that the IRS will levy upon the taxpayer's assets to collect the delinquent tax. This is the point at which the IRS must use more expensive collection methods. This proposed change was included in the President's tax reform package and is part of H.R. 3838 (The Tax Reform Act of 1985) which passed the House of Representative in December, 1985.

SENATOR ABDNOR: IRS had planned to implement the Civil Penalty Master File in 1985 for the purpose of informing management of the various types of penalties that were being assessed.

Has the file been implemented?

MR. EGGER: The Civil Penalty Module was implemented on May 1, 1985.

SENATOR ABDNOR: If so, does it provide IRS with adequate information to track the different types of civil penalties?

MR. EGGER: A quarterly computer report is generated which shows, by region, for each penalty assessed in the Civil Penalty Module, the number and amount of assessments and abatements. National totals are also generated for the above information. This information is felt to be adequate to track the civil penalties.

COLLECTION RESOURCES

Senator ABDNOR: During the Fiscal Year 1986 appropriations hearings, IRS stated that approximately 21 percent of its resources were devoted to collecting delinquent taxes from fiscal years 1982 through 1984 compared to an estimated 19 percent in fiscal years 1985 and 1986. IRS has taken the position that additional delinquency collection would be accomplished primarily by improving the effectiveness and efficiency of its' collection programs. At the same time, however, IRS is strengthening its other compliance programs, such as document matching, and plans further increases in its examination staff, which should increase the number and amount of delinquent taxes requiring collection action.

What was the actual percentage of IRS resources devoted to collecting delinquent taxes fiscal year 1985? What percentage of resources does IRS plan to devote to collecting delinquent taxes during fiscal years 1986 and 1987?

Mr. EGGER: For FY 1985 19.7% of the Service's resources were devoted to collecting delinquent taxes. We estimate that for FY 1986 and FY 87 the Service will devote over 17% of its resources to Collection programs.

Senator ABDNOR: What are the number of positions IRS devoted, or plans to devote, to collecting delinquent taxes for Fiscal Years 1980 to 1987?

Mr. EGGER: The following chart reflects Collection positions since FY 1980:

FY	Positions
1980 (actual)	11,705
1981 (actual)	13,185
1982 (actual)	15,620
1983 (actual)	18,149
1984 (actual)	19,149
1985 (actual)	18,132
1986 (estimate)	16,056
1987 (estimate)	16,068

Senator ABDNOR: How many additional delinquencies does IRS expect to be generated through improved compliance programs? How does IRS intend to effectively deal with these increased delinquencies given its anticipated resource levels?

Mr. EGGER: At this time we cannot put a specific number on how many additional delinquencies could be generated through improved compliance programs. Collection, however, is currently testing several programs to identify additional delinquencies. One of these tests which involve revenue officers examining employment tax returns has been very successful to date with a return of $10 for every $1 spent. Absent increased staffing, Collection is looking at new and innovative automation efforts as described earlier as the means for effectively dealing with the increased delinquencies.

"CURRENTLY NOT COLLECTIBLE" ACCOUNTS

Senator ABDNOR: At the end of fiscal year 1984, the inventory of accounts classified as "currently not collectible" totaled $6.3 billion. The Internal Revenue Code gives IRS six years from the date of assessment to collect delinquent taxes. During those six years, IRS can collect delinquencies previously classified as "currently not collectible" through a number of different methods, such as reactivating the accounts and taking additional collection actions or offsetting subsequent refunds against these delinquencies. However, after the statute of limitations expires, IRS has no legal recourse to collect these delinquencies. During calendar year 1984, $757 million was written off because the statute of limitations expired. This was a 27 percent increase over 1983 and a 51 percent increase over 1982.

What amount of delinquent taxes were classified as "currently not collectible" in fiscal year 1985?

Mr. EGGER: At the end of FY 85 there was $7.6 billion in delinquent accounts classified as currently not collectible.

Senator ABDNOR: How much of the delinquencies previously classified as "currently not collectible" was collected in fiscal year 1985? How much of these collections was from refund offsets?

Mr. EGGER: In FY 85 we collected about $160 million on accounts previously reported as currently not collectible. Of that amount, $68.3 million was applied from offsets of current year refunds and other overpaid accounts . Over $90 million was collected as a result of our follow-up actions.

Senator ABDNOR: What amount of delinquent taxes was written off in fiscal year 1985 due to the expiration of the statute of limitations? How does this amount compare to the amounts of taxes written off in fiscal years 1983 and 1984? To what extent does IRS attribute these changes in amounts written off?

Mr. EGGER: The chart below reflects the amounts written off due to statute expiration for FY 1983, 1984, and 1985. The amount written off decreased by $124 million in FY 1985 and total write-offs compared to collections have fallen below FY 83 levels. We believe that our progress in this area is attributable to the improved ability our automation efforts have provided for subsequent collection actions on the currently not collectible accounts.

($000s)	FY 1983	FY 1984	FY 1985
lost to statute expiration	$595,000	$757,000	$633,000
total $ collected	$16,171,000	$16,447,000	$18,253,000
statute expiration as % of total $ collected	3.7%	4.6%	3.4%

Senator ABDNOR: What breakdown can IRS provide on the type of taxpayer and amount of taxes written off during fiscal year 1985 because of statute expiration? What are the reasons these taxes could not be collected during the 6 year period?

Mr. EGGER: Over 77%, or $487 million, of the amount written off for FY 1985 was from delinquent business taxes. The remaining $146 million was due from individuals. The majority of amounts written off result from cases where we cannot locate or contact the taxpayer of where we have determined the taxpayer does not have the financial ability to pay. A significant portion of the amount written off in inability to pay cases results from bankrupt or defunct corporations. We do subsequently recoup a large portion of that amount from the responsible officers under the penalty provisions of IRC 6672. We are continually reviewing our procedures to ensure that where new information becomes available we pursue collection. For example, we have a major project underway to expand the use of automated sources for locating taxpayers, e.g., automated telephone number lookup and access to credit bureau information, which will significantly improve our ability to timely contact delinquent taxpayers.

ABATEMENTS

Senator ABDNOR: IRS collection personnel can abate taxes, interest, and penalties if they determine through contact with taxpayers or other means that these amounts should not have been assessed.

What amount of taxes, interest, and penalties did IRS Collection personnel abate during fiscal years 1984 and 1985? Have these abatements been increasing over the past few years? To what does IRS attribute any changes in the amounts of abatements?

Mr. EGGER: During fiscal year 1985 IRS personnel abated $19.4 billion in taxes, interest and penalties. This compares with $8.4 billion in fiscal year 1983 and $6.3 billion in 1984.

There are two reasons for the large increase in FY 1985. The first is the difficulty both the Service and taxpayers experienced with revised Federal Tax Deposit (FTD) forms. This along with other service center processing problems this past year caused delays in posting taxpayer payments. Subsequently, we were required to abate penalty and interest as we cleared up the delays. We expect to see abatements fall more in line with past years now that we have resolved the delays.

Senator ABDNOR: What breakdown can IRS provide as to the amounts and reasons for these abatements?

Mr. EGGER: Of the $19.4 billion that was abated in fiscal year 1985, $16.5 billion was on accounts that were in notice status, $1.3 billion was from active Taxpayer Delinquent Accounts and $1.6 billion was on system monitored accounts.

The extremely high notice abatements are due to the problems described above. Generally though, our abatements result when a taxpayer provides us with information to show that the tax was assessed in error or that a payment was made but not credited to the account.

LEVIES

Senator ABDNOR: Levying taxpayers' assets is a major collection tool used by IRS. During fiscal year 1984, IRS issued 1,484,000 levies. After appropriate written notice has been given the taxpayer, IRS can use levies at any time in the collection process. IRS' first use of levies occurs when the account is transferred from the service center to ACS. This initial levy is computer-generated before any telephone or personal contact with the taxpayer is attempted. During the fiscal year 1986 appropriations hearings, IRS mentioned that it did not have any information on the amount of money collected by levies, the percentage of levies that resulted in the collection of delinquent taxes, or the number of erroneous levies issued.

How many times did IRS use its levy powers during fiscal year 1985? How many of these levies were systemically issued at the time the delinquent account was transferred from the service center to ACS? How many levies were issued by revenue officers?

Mr. EGGER: During fiscal year 1985 we issued 1,418,000 notices of levy. Of these, 980,000 were on ACS cases. That figure includes both systemically issued levies and those issued after a call site employee attempts to contact the taxpayer. Field revenue officers issued 438,000 notices of levy in 1985.

Senator ABDNOR: Has IRS developed any information on the results of its levy efforts? If so, what percentage of levies result in the collection of delinquent taxes and how much money is collected through levies? If IRS does not have this information, how can it effectively evaluate its use of levies as a collection tool?

Mr. EGGER: While we cannot give specific data on the dollars collected through levy action, we know that from an operational standpoint our levy is an effective collection tool. For example, in FY 1985 our Automated Collection System (ACS) collected $2.3 billion, much of which came from the almost 1 million levies served. Again, on a day-to-day basis we know that when dealing with uncooperatiave taxpayers a levy is often the only means of securing payment. Oftentimes, taxpayers will submit voluntary payments when advised of our levy authority. We are continually reviewing our levy procedures to improve the process. We recently reviewed the source data to ensure that we are using the most current information available for our levy source and that where multiple sources are available we contact the source with the highest payoff likelihood first. We have established a Collection research file that will permit us to further examine the effectiveness of our levy.

Senator ABDNOR: Considering the problem IRS has had in processing taxpayer information at its service centers, what additional controls have been established to ensure that erroneous levies are not issued?

Mr. EGGER: Our procedures require that current taxpayer account information be checked before a notice of levy is issued. We have also stressed to our managers and employees the necessity to review and take appropriate action to prevent issuance of any levy where doubt exists as to the liability. As the problems at the service center occured and the backlog of correspondence grew, we lengthened the amount of time between notices or delayed notice issuance to allow more time for the taxpayers responses to be processed. Several times in the last year entire batches of levies were not issued when we became aware of potential errors. Subsequent reviews indicated that actual number of erroneous levies in these batches was very small. We also instituted systemic and procedual safeguards to prevent automatic levy issuance when there was an undelivered notice.

On those occasions where an error was made, we took immediate action to correct the situation. When we became aware that a notice of levy had been inappropriately issued, we released the levy and sent both the taxpayer and the recipient of the levy a letter of apology. If an inappropriate levy resulted in excessive collection of the account, we took immediate steps to initiate a manual refund.

Senator ABDNOR: How many erroneous levies did IRS issue during fiscal year 1985? If this information is not available, how can IRS ensure that controls over the issuance of erroneous levies are operating effectively?

Mr. EGGER: We know that the number of taxpayers complaints is relatively small considering that we issued over 1.4 million notices of levy. I believe the safeguards and procedures previously outlined provide taxpayers adequate protection and help ensure that our levy is appropriate in the majority of cases.

LIENS

Senator ABDNOR: A statutory lien upon all taxpayer property arises at the time a taxpayer fails to pay delinquent taxes upon demand. However, to be effective, IRS must file notice of the lien with the appropriate federal, state, or local officials. During fiscal year 1984, IRS filed 846,229 liens. The lien remains in effect until the tax liability is satisfied or the statutory six year period for collection expires. The Tax Equity and Fiscal Responsibility Act of 1982 requires IRS to release liens within 30 days of the date the lien becomes unenforceable. This provision applies to all liens filed or fully satisfied after December 31, 1982.

How many lien notices did IRS file during fiscal year 1985? What amounts of delinquent taxes were covered by these liens?

How many lien notices were still in effect at the end of fiscal year 1985? What amount of the delinquency inventory was covered by these liens?

Mr. EGGER: The IRS filed 705,000 notices of lien in fiscal year 1985. We estimate that at the end of FY 1985 we had over 2 billion outstanding liens filed. During FY 1985 we released about 334,000 liens.

We do not specifically know the amount of delinquent taxes covered by these liens. However, the outstanding balance of accounts in active inventory and currently not collectible status at the end of FY 1985 was $16.6 billion. Federal tax liens have been filed on many of these accounts.

Senator ABDNOR: How much money was collected during fiscal year 1985 as a result of liens?

Mr. EGGER: The notice of lien is one of several enforcement tools the IRS uses to collect delinquent taxes. We use our various enforcement tools in an integrated effort to collect the entire delinquent tax liability. It is difficult to determine which action had the greatest effect in securing the balance due since many of the delinquent accounts are closed by voluntary payments after an enforcement action is taken. Additionally, the filing of a notice of tax lien in a particular case may prompt the taxpayer to also pay a delinquent account for which a notice of tax lien has yet to be filed.

Senator ABDNOR: Were any erroneous liens filed in fiscal year 1985. What procedures does IRS have in place to correct such liens?

Mr. EGGER: While we do not keep track of the number of erroneous liens filed. We have received very few complaints from taxpayers considering we filed over 700,000 liens in FY 85.

As with our levy program, current taxpayer account information is checked before a notice of lien is filed. When we become aware that an erroneous notice of lien has been filed, we take immediate steps to release it. When appropriate, the District Director issues a letter of apology which the taxpayer can furnish to the appropriate persons or organizations.

Senator ABDNOR: How many lien notices became unenforceable in fiscal year 1985 for which IRS was required to release the liens in 30 days? How many of these liens were released within the 30 days?

Mr. EGGER: The 30 day release requirement of IRC 6325 applies only to liens filed or fully satisfied after December 31, 1982. Our procedures require that when a lien is fully satisfied we expedite release to meet the 30 day requirement. We have recently automated our lien processing system to help ensure that we meet the 30 day release requirement. In FY 1985 we released 334,000 liens.

We continue to emphasize this area during management reviews to ensure that we comply with this requirement in all cases.

We have revised our tax lien filing process for all liens filed after 1982 to include a statement on the tax lien that shows the date the lien becomes unenforceable. Since our tax liens are public records, this ensures, in effect, a timely release of unenforceable liens.

INSTALLMENT AGREEMENTS

Senator ABDNOR: IRS can allow taxpayers to pay their delinquent taxes through installment agreements if it determines that taxpayer cannot fully pay the tax delinquency. IRS bases this decision on financial information provided by the taxpayer.

How many installment agreements were issued in fiscal year 1985? What was the amount of tax delinquencies covered by these installment agreements? How do these figures compare with IRS' use of installment agreements in fiscal years 1983 and 1984?

Mr. EGGER: The number and amount of installment agreements for FYs 1983, 1984 and 1985 are shown below:

INSTALLMENT AGREEMENTS
(Amount in $000,000's)

	FY 1983	FY 1984	FY 1985
Number	592,000	670,000	556,000
Amount	$1,008	$1,241	$1,187

Senator ABDNOR: How many accounts were fully paid by installment agreements in fiscal year 1985? How much money was collected on these accounts during fiscal year 1985?

Mr. EGGER: During FY 1985 we closed 305,000 accounts and collected $619 million on installment agreements.

Senator ABDNOR: How many installment agreements defaulted in fiscal year 1985? What was the final disposition of the delinquencies involved in these defaulted agreements?

Mr. EGGER: During FY 1985 176,000 agreements defaulted. After an account defaults, it is treated in the same manner as other delinquent accounts and the final disposition is captured along with the other delinquent accounts.

Senator ABDNOR: What does it cost IRS to enter into and monitor installment agreements?

Mr. EGGER: Because we have streamlined our installment agreement process and the cases are systemically monitored, installment agreements are one of our most cost effective collection tools. We estimate that the average cost of securing and maintaining an installment agreement is $30.00. Early in FY 1987, we will implement nationwide electronic fund transfer for installment payments which will further reduce our processing costs.

Senator ABDNOR: What percentage of the installment agreements issued, fully paid, and defaulted in fiscal year 1985 were business taxpayers?

Mr. EGGER: Business taxpayers accounted for 4% of the installment agreements issued, 2% of the full paid agreements and 8% of the defaulted agreements.

Senator ABDNOR: What criteria does IRS use to determine whether installment agreements should be granted and is this criteria different for individuals and businesses?

Mr. EGGER: The IRS regards an installment agreement as a privilege extended to taxpayers only when the specific situation warrants. Collection employees analyze income, expense and asset information before determining that an agreement is appropriate. Only in cases where liquidation of the taxpayers assets would create a hardship are agreements considered. The payment amount is based on an individual's particular financial situation.

Since business tax liabilities usually involve trust fund taxes withheld from employees, we apply stricter criteria in those cases. First, only field revenue officers can enter into an installment agreement with an in-business taxpayer. Second, we closely monitor the taxpayer to ensure that current tax deposits are being made as well as the agreed payment. Failure to either make the payment or tax deposits causes an account to default. We have instituted procedures to immediately follow-up with enforcement action on those defaulted agreements.

FEDERAL TAX DEPOSIT ALERT PROGRAM

Senator ABDNOR: IRS uses the Federal Tax Deposit (FTD) Alert Program to identify employers who fail to make their required deposits of withheld taxes. IRS uses this program to identify and contact potentially delinquent taxpayers before their quarterly tax returns are due to prevent these taxpayers from becoming delinquent.

How many FTD alerts did IRS collection personnel work in fiscal year 1985?

Mr. EGGER: In FY 1985, IRS worked 42,000 FTD alerts.

Senator ABDNOR: How many FTD alerts resulted in IRS securing the quarterly tax return with full payment?

Mr. EGGER: The FTD alert program has been very beneficial in allowing us to identify delinquent business taxpayers and prevent pyramiding of tax delinquencies. Once a delinquency is identified, procedures require that we secure the tax return and take appropriate enforcement actions which range from accelerating assessment of the return to monitoring the taxpayers compliance with the federal tax deposit requirements. While we do secure tax returns and follow-up on payments where taxpayers are delinquent, our reporting system does not specifically identify returns secured from the FTD alert program. In FY 1985, we secured over 3.7 million delinquent returns from all Collection programs.

Senator ABDNOR: How many businesses which IRS contacted based on the FTD alert program in fiscal year 1985 failed to pay their taxes and subsequently became delinquent?

Mr. EGGER: We know that the early contact and monitoring we make through the FTD alert program prevents many taxpayers from becoming delinquent. We do not know however how many of the taxpayers we contact subsequently become delinquent. Our Collection research file will enable us to determine the impact of FTD alerts on subsequent compliance.

Senator ABDNOR: How much does it cost IRS to work FTD alerts?

Mr. EGGER: In FY 1985, the Service spent about $2.6 million administering the FTD alert program.

TAX SHELTER-RELATED COLLECTIONS

Senator ABDNOR: IRS has made the examination of tax shelter cases its number one priority. During the fiscal year 1986 appropriations hearings, IRS stated that it assessed about $2.2 billion in additional taxes and penalties from tax shelter examinations in fiscal year 1984. IRS expected this figure to increase in the following two fiscal years.

Has the collection of tax shelter assessments caused IRS any special collection problems?

Mr. EGGER: To date we have not experienced any special collection problems. Where the taxpayer agrees with our assessment they have generally voluntarily paid the additional tax.

Senator ABDNOR: As the number of examinations increase, does IRS foresee any significant collection problems in the future? If so, how is IRS planning to cope with these problems?

Mr. EGGER: We are concerned that the unagreed cases could cause Collection problems once the appeal process is completed. For this reason, we are providing training to our enforcement personnel that gives them a basic understanding of tax shelters and increases their awareness of problems that could arise during the collection process.

SENATOR ABDNOR: IRS has made the examination of tax shelter cases its number one priority. During the fiscal year 1986 appropriations hearings, IRS stated that it assessed about $2.2 billion in additional taxes and penalties from tax shelter examinations in fiscal year 1984. IRS expected this figure to increase in the following two fiscal years.

What percent of the $2.2 billion in fiscal year 1984 tax shelter additional recommended tax has been collected to date? What percentage of these assessments have been abated?

MR. EGGER: We have no data on abatements for shelters. We do not have specific data on collected tax for shelter examinations. However, based on data for the examination program as a whole, we estimate that $1.5 billion were collected through FY 1985 based on FY 1984 recommendations of $2.2 billion. Further, we estimate that ultimately a total of $1.7 billion will be collected on FY 1984 recommendations.

SENATOR ABDNOR: How much does IRS expect to generate in additional recommended tax in fiscal years 1985 and 1986?

MR. EGGER: Additional recommended tax, penalties, and interest resulting from tax shelter examinations closed during FY 1985 was $2.5 billion. Through December 1985 the additional recommended tax, penalties and interest for FY 1986 was $721 million.

LONG RANGE PLANNING

SENATOR ABDNOR: In May 1984, IRS published its strategic plan with 14 specific initiatives to develop an information management strategy. These initiatives include things, such as the establishment of an information management resource function and a telecommunication strategy. The goal was to facilitate the transition to a predominantly computer and information technology environment.

These strategic initiatives were assigned to various IRS executives to develop implementation plans and oversee their execution. These plans were approved in 1984 with completion dates ranging from mid-1985 to 1990.

Have any of the 14 strategic initiatives been partly or fully completed? What is the timetable for completion?

MR. EGGER: One of the strategic initiatives, IMS-8, entitled User Guidance for Systems Development, has been completed. The recommendations were approved by the Automation Policy Board on January 28, 1986, and are currently being implemented by the affected organizations.

Others, such as IMS-6, Separate Applications Development and Processor Procurement, have been partially completed. One significant action toward implementation of this initiative was the establishment of the User Assistance and Computer

Capacity Management Office to perform capacity planning for the Service.

The timetable for completion of these strategic initiatives varies from calendar year 1985 out to calendar year 1991 for IMS-13 for the establishment of an integrated telecommunications network. Others, such as IMS-7, Formalize Processes for Dealing with Human Resources Impacts, will continue indefinitely with studies of future and long range impacts.

SENATOR ABDNOR: Have there been, or will there be, any organizational or systemic changes resulting from the implementation of the 14 strategic initiatives?

MR. EGGER: Several of the strategic initiatives are expected to have organizational impacts. For example, IMS-2, Establish an Information Management Function, is anticipated to result in organizational realignments, and others, such as IMS-1, Establish a Data Management Environment, and IMS-3, Clarify Research and Development Organizational Responsibilities, may also. One initiative, IMS-6, Separate Applications Development and Processor Procurement, has already resulted in an organizational change with the establishment of the User Assistance and Computer Capacity Management Office to perform capacity planning for the Service.

The IMS initiatives represent a directional plan providing a framework within which operational and implementation plans will be developed. We expect numerous organizations and systemic changes to result from their implementation.

SENATOR ABDNOR: Has IRS developed an overall strategy to integrate the various components of each of the 14 strategic initiatives?

MR. EGGER: The 14 strategic initiatives reflect the Service's goal of establishing a comprehensive system of readily accessible information required for tax administration processes. Integration of these strategic initiatives to help attain this goal, as well as individual automation projects and initiatives, is under the guidance of the Service's Automation Policy Board, chaired by the Deputy Commissioner.

INTEGRATED DATA RETRIEVAL STSTEM REPLACEMENT PLANS

SENATOR ABDNOR: IRS' Integrated Data Retrieval System (IDRS) provides instantaneous visual access to taxpayer accounts. IDRS supports crucial IRS functions, such as responding to taxpayer inquiries, processing certain types of refunds, making adjustments to taxpayer accounts, examining taxpayer returns, collecting taxes, and investigating tax crimes. IDRS consists of Sperry Univac 1100/84 computers and associated peripheral tape and disk subsystems, Sperry and Control Data Corporation terminals, and a Sperry Univac 9040 Data Communications Processing System.

To meet the demands of a growing workload, IRS is using a two phase procurement to upgrade the entire IDRS system. Phase I, costing about $17 million, occurred in 1984-1985 when about 4,000 Sperry terminals were added to the system. Phase II, which is expected to exceed $100 million, will include replacing about 4,100 old Control Data terminals and providing 900 expansion terminals with an option to add up to about 5,000 more. Phase II also involves replacing and upgrading the 9040 communications processor. The communications processor performs communications tasks, such as routing messages between the terminals and the Univac 1100 mainframe computers. It is a key component because all on-line inquiries must pass through it to access data bases on IRS' mainframe computers. There is only one communications processor at each of IRS' 10 service centers.

A 1984 IRS capacity study concluded that the workload in the larger service centers could exceed the 9040's capacity during peak hours as early as December 1985. If this occurs, it would hamper IRS' taxpayer service, collection, error resolution and other activities at these centers.

IRS awarded the IDRS Phase II contract in October 1985 and planned to install upgraded communications processors at 2 service centers in 1986. In other words, only 2 of the 10 service centers would have upgraded processors for the 1987 tax filing season. The remaining 8 service centers would have them installed in 1987, after the tax filing season. However, a protest of the awarded contract was filed and recently upheld, thus clouding the future of this acquisition. The Phase II procurement is also to give IRS a major additional communications capability, called the Communications Replacement System, to interface IDRS with several other IRS systems. The Request for Proposals requires the new communications processors to be able to interface IDRS not only with the Sperry Univac mainframes; but also with the Distributed Input System, the Automated Collection System, and the Zilog minicomputers.

When does IRS anticipate installation of the Phase II terminals? What locations will receive these terminals, and for what applications will they be used?

MR. EGGER: The award was protested by the unsuccessful bidders, and the contract with Computer Systems and Resources, Inc. (CS&R) was ultimately terminated by order of the GSA Board of Contract Appeals. The contract was awarded to Sysorex Information Systems, Inc. on February 11, 1986. A motion to stay the award of the contract to Sysorex, which was filed by CS&R, was recently denied. Performance under the Sysorex contract is currently proceeding.

Under the current project schedule, the Communications Replacement System (CRS) test system will be installed and ready for use in the National Computer Center, Martinsburg, West Virginia, in July 1986. The first Service Center, currently identified as Atlanta, will have its old terminals and communications processor replaced in November 1986. No installations will be made during the January through April 1987 filing season. The last Service Center, as yet to be determined, will be installed in December 1987. An action plan is presently being developed to finalize the order of

Service Center installations. The volume of IDRS transactions in a Service Center is the primary factor affecting its installation order. However, negotiations are currently underway to accelerate this schedule by installing three additional systems for our largest Service Centers, and remote terminals for all Service Centers before the 1987 filing season.

The Sperry DCPS and an average of 410 CDC terminals will be replaced in each Service Center network. Approximately 60% of the CDC terminals are physically located in the Service Centers. The remaining CDC terminals are located in District Offices and Posts of Duty. A detailed list of terminal quantities and locations was included in the solicitation; however, a number of office relocations have since occurred. We are currently compiling a list of changes to the initial delivery schedule.

The new terminals will be used for the same activities as the CDC terminals which they are replacing. Most of this activity relates to taxpayer account information needed by the Service Centers and District Examination, Collection, Criminal Investigation and Internal Audit functions.

SENATOR ABDNOR: If IRS encounters delays in Phase II implementation, how will it effect IDRS and the systems it supports? What contingency plans does IRS have if delays occur?

MR. EGGER: The effect of delays in the Phase II implementation depends upon the amount of delay. The most immediate impact of delays would be: (1) increasing failures and repair costs of old Control Data Corporation terminals; (2) downtime of the existing Sperry Data Communications Processing System (DCPS) due to age and lack of redundant components; (3) inability to increase the number of terminals connected to the Service Centers to handle workload growth or new applications.

If significant delays are encountered, we are ready to address the reliability of the old Control Data Corporation (CDC) terminals by either: (1) requesting another Delegation of Procurement Authority from GSA for a sole source acquisition of replacement terminals from Sperry; (2) retiring failed CDC terminals from inventory and using their good parts to keep other old CDC terminals functioning.

Our contingency planning is also addressing the problem of the aging and capacity limited Sperry 90/40 Data Communications Processing System (DCPS). In order to address the lack of system redundancy in case of failure, we are investigating the possibility of purchasing additional Sperry DCPS's for all, or a limited number, of Service Centers. In that area we are also investigating the possibility of simultaneous operation of two DCPS's during real time to share the transaction processing load and allow more terminal traffic with adequate response time.

SENATOR ABDNOR: When does IRS estimate the Communications Replacement System will be installed?

MR. EGGER: The CRS test system will be installed at the National Computer Center in Martinsburg, West Virginia, in July 1986. The first Service Center, now scheduled to be Atlanta, will be installed in November 1986. The remaining Service Centers will be installed between May 1987 and December 1987. No installations will occur during the January through April 1987 filing season to avoid Service Center disruptions. We are exploring the possibility of installing the four high volume Service Center systems prior to January 1987.

SENATOR ABDNOR: Is IRS measuring utilization of the communications processors? If so, how much additional workload can the processors handle? If not, how will IRS know whether they will meet its needs until the Communications Replacement System is implemented?

MR. EGGER: There are no tools on the 9040 Data Communications Processing System (DCPS) to routinely measure system or component utilization, as is common on larger, more sophisticated systems. We have, however, established precise performance (resource utilization) data by using a hardware monitor during live, production workloads. These performance data were refined and input to an analytical modeling program. When correlated with workload data, which is gathered routinely, the model forms the basis for capacity assessments. Modeling studies in 1983 and 1984 projected probable capacity saturation of the DCPS processor in 1985.

Although actual capacity varies according to workload (transaction) characteristics, peak workload at the larger Service Centers in 1985 effectively saturated the DCPS. Our projections show that additional workload during peak periods of the day will cause degraded response time to terminal operators. However, since there is sufficient total capacity to accomplish projected work, leveling (reducing demand peaks) can alleviate peak period degradation. One means of accomplishing leveling, increasing real time availability to users from approximately 12 hours to 16 or more hours per day, is in place for 1986. With workload leveling and installation of the CRS at the higher volume Service Centers prior to peak 1987 IDRS processing, there will be adequate capacity to accommodate projected workload.

SENATOR ABDNOR: To what degree does the 90/40 Data Communications Processing System have maintenance problems? We understand the 90/40 at a service center was recently disabled, but that a replacement was brought in within 30 hours. What measures does IRS plan to take if the 90/40 at two or more service centers are disabled at the same time?

MR. EGGER: The 90/30 communication processing systems were installed in 1979, upgraded to a 90/40 in 1983 and are beginning to experience hardware failures. We are in the process of compiling accurate statistics, but do not have those figures at present, since each Service Center maintains its own maintenance records. Sperry has identified two spare 90/40 systems as replacements in the event of a failure. One of those systems is on-site in the Atlanta Service Center. The other is in a non-IRS site in Minneapolis, Minnesota. Both systems are available for shipment to any Service Center on an emergency basis.

SENATOR ABDNOR: Does IRS have a communications plan which shows the goals to be achieved with the interface capabilities to be provided by IDRS Phase II? Has IRS studied how this will meet user needs? When does IRS estimate this capability will be used?

MR. EGGER: The feasibility study upon which the IDRS Terminal Replacement project is based was completed in December 1982. It included the user needs and interface capabilities which were known or estimated at the time. The Request for Proposals evolved over the period March 1983 to August 1984. Many IRS functions as well as the computer industry reviewed the RFP and provided input. The contract was finally awarded in February 1986 after protest of the initial award in October 1985. We currently have several efforts underway analyzing the evolution of IDRS applications and needs since the original feasibility study in order to predict future needs.

The specific interface needs which were incorporated into the RFP were related to the Automated Collection System (ACS), the Distributed Input System (DIS), Zilog minicomputers and IBM 308X series computers.

At present, separate IDRS terminals are needed by ACS to gain access to the IDRS system, this reduces the productivity of the ACS personnel. The interface requirement was included in the RFP in order to allow ACS terminals to gain access to IDRS without the need for separate terminals.

The DIS interface was included with a similar intent, to permit switching the DIS terminals between the IDRS and the DIS host computer systems electronically for a productivity improvement and the avoidance of additional terminal hardware costs.

The Zilog interface was included to permit basic compatibility between the many Zilog minicomputers in IRS and the new CRS for information interchange. Our field offices have tailored local Zilog applications to improve productivity for individual tax administration functions. Many of these functions require information from IDRS.

The IBM 308X series computer interface was included to insure compatibility should the present Sperry 1100/8X host system be replaced with an IBM compatible system. Since many large mainframe systems offer IBM compatibility, this was the most feasible interface requirement for this possibility. It would be impossible to require interface compatibility with every type of large computer mainframe in the industry. For planning purposes, the acquisition of the interfaces was estimated for the 13th (ACS), 25th (DIS) and 37th (Zilog and IBM) months after contract award. Actual interface installation dates are currently under discussion.

SENATOR ABDNOR: Will the changes being made to the IDRS system increase the demand on IRS' main Sperry Univac computer? If so what effect will this demand have on other critical workloads on these computers?

MR. EGGER: No, the Sperry Univac system (SCRS) will not experience increased workload attributable to IDRS (CRS and terminal replacement) system changes.

SENATOR ABDNOR: What new applications are currently planned for the IDRS/CRS system? Was this system size based on the current IDRS workload or were the planned new applications also considered?

MR. EGGER: Additional Taxpayer Service terminals and the Automated Underreporter Program are the primary applications planned for the IDRS system which will require expansion of the network. The system size in the RFP was based upon transaction volume growth estimates through 1991 and a network of approximately 1400 terminals per Service Center. At present there are approximately 810 terminals per Service Center. The growth estimates included the terminal traffic which would be generated by the addition of up to 5000 IDRS terminals to the present 8225 nationwide. The additional Taxpayer Service and Underreporter terminals would be acquired from the 900 expansion terminals in the initial delivery of 5000 terminals and the optional 5000 terminals available under the Sysorex contract.

SENATOR ABDNOR: To what extent does old software need conversion or new software need to be written to complete the IDRS/CRS replacement? When would this be completed?

MR. EGGER: The contract requires that all deliverable software be newly developed because of additional program requirements and redesign of the existing programs for efficiency. All software is required under the terms of the contract to be delivered in July 1986, five months after contract award.

SENATOR ABDNOR: Does IRS measure availability of the IDRS system and of major applications on the system? If so, do they indicate whether there is any availability problem?

MR. EGGER: Yes, the IDRS availability is tracked via daily input to the National Office by the Service Centers into the Computer Branch Accomplishments Reporting System (CBAR). There also is daily tracking of the Error Resolution System, Generalized Unpostable Framework, Generalized Mainline Framework, as well as the Microfilm Replacement System. Daily and weekly batch processing of the Taxpayer Information File, the largest and most active portion of the IDRS data base, is tracked through CBAR, as well as general online response time information. By daily and weekly tracking, the awareness of an availability problem is detected and addressed at an early stage. Status information and the results of our analysis are regularly made available to National Office executives as well as the Regions and Service Centers.

SENATOR ABDNOR: In its review of IRS' service centers, the General Accounting Office (GAO) found specific functions, such as Collection, Criminal Investigation, Notice and Refund Review, lacking a sufficient number of IDRS terminals available in the function's specific organizational area. Thus, the staff in one function had to use terminals, when available, in other functional areas of the service center.

Do the service centers now have sufficient IDRS terminals to access file information on taxpayers' accounts?

MR. EGGER: We are aware of a shortage of terminals in the Taxpayer Service function. In an effort to meet this need, we recently obtained 125 Sperry terminals for Taxpayer Service and we plan to allocate a significant number of the expansion terminals under the Sysorex contract to this function. We also plan to compile requests for additional terminals from other functional areas within the next six months. We will prioritize those requests in accordance with available funding and justification and, as resources are available, acquire additional terminals from the 5000 optional terminals available under the Sysorex contract.

SENATOR ABDNOR: Does IRS have a long range plan to ensure sufficient capability to access tax account information?

MR. EGGER: The growth rate in IDRS terminal transactions was analyzed and included in the Phase II solicitation. Sufficient growth estimates were specified through 1991 based on historical data. The solicitation specifications required that bidders propose optional upgrades to increase system capacity in the event that transaction volumes grow faster than our estimates. Proposals which included higher capacity optional upgrades without recompetition were scored more highly.

SENATOR ABDNOR: An October 1, 1985 telecommunications study within IRS' Support and Services office noted that the communications systems connecting thousands of remote IDRS terminals to IRS service centers would need to be greatly enhanced by 1990 to meet growing workload demands. Since long term solutions would be costly and probably have to go through a lengthy procurement process, interim as well as long term solutions were proposed. To what extent has IRS addressed this potential problem?

MR. EGGER: The IRS is presently studying three alternatives to meet the long term problem of increased workload on the IDRS network:

1. Redesigning the existing network with fewer terminals on a given line working at a higher speed to maintain the current desired response times of this critical tax processing application. This solution would involve increasing the number of data communications lines and replacing the existing data communications equipment (modems, multiplexers, etc.) with equipment capable of operating at higher speeds.

2. Conducting a test of newly available satellite technology that would be capable of operating at higher speeds but at lower cost than the current terrestrial facilities.

3. Conducting a test using packet switched technology.

SENATOR ABDNOR: Under what procurement would a solution be addressed?

MR. EGGER: Solutions 1 and 2 would require full, competitive procurement actions once authority

is received from the Department and GSA. Solution 3 can be accomodated under the existing contract for the Treasury Consolidated Data Network which is under the control of the U.S. Customs Service as the Executive Agent for data transmission within the Department.

CAPACITY ENHANCEMENT FOR THE PROCESSING SYSTEM (CEPS)

SENATOR ABDNOR: In 1985, IRS implemented the Service Center Replacement System (SCRS). Under SCRS, Univac 1100 series computers were installed at IRS' ten service centers, which handle most tax return processing functions. It also involved the conversion of about 1,500 computer programs from assembler language to COBOL. At the start of the 1985 tax filing season, a combination of insufficient computer capacity and inefficient computer software associated with SCRS adversely affected the Service centers' ability to process tax returns and service taxpayers.

Although IRS originally intended for SCRS to provide sufficient capacity until the late 1980's, we understand that IRS is now planning a new acquisition strategy known as the Capacity Enhancement for the Processing System (CEPS). This initiative would not only involve replacing the existing Sperry hardware provided under SCRS, but also would involve changing the existing software programs to be compatible with the new equipment. Under this procurement the winning vendor will be responsible for converting the existing IRS software to run on the proposed equipment. Therefore, careful planning is needed to prevent disruptions to IRS operations with the CEPS conversion.

What is the status of the CEPS procurement, including the timetable for award, installation, testing and implementation?

MR. EGGER: The CEPS Request for Proposal (RFP) is currently awaiting approval for issuance to industry. Contract award is planned for March, 1987. CEPS installation at NCC is scheduled for completion by July, 1987. The contractor completion of the software conversion is scheduled for April 1988. Hardware acceptance testing is to be completed by September 1989. Full installation and implementation at all Service Centers is to be completed by October 1989.

SENATOR ABDNOR: To what extent has IRS documented its current system to better prepare contractors who may bid on CEPS? For example, has IRS prepared an inventory of its computer programs and its data files? If so, how recent is this inventory?

MR. EGGER: We have prepared a detailed inventory of the SCRS software to be converted to CEPS. The original inventory was prepared in mid-1984, and was updated in 1985; the final preparation for inclusion in the CEPS RFP occurred at the end of September 1985. We have continued to update the inventory to ensure that all software to be converted is included in the contract.

Additionally, we have also included options in the CEPS RFP for the conversion of software that may be identified after contract award. Since the effort is strictly for conversion of existing SCRS software, (not for new development of additional applications), we have developed a very detailed inventory, down to the individual program level, and have included all relevant data. We obtained the guidelines available from the Federal Software Conversion Center at GSA, which specified the level of detail needed by industry for determination of the effort needed and the development of cost proposals.

Documentation for the existing SCRS software is updated yearly to reflect changes made for each tax season. As an additional safeguard, it is currently being reviewed and, when needed, updated to ensure that it is correct when it is provided to the winning vendor with the programs for conversion.

SENATOR ABDNOR: Has IRS done a conversion study for CEPS? If so, (a) what is the estimated level of conversion necessary, (b) How long will it take, and (c) what is the estimated cost?

MR. EGGER: The IRS completed a Conversion Study of the processing functions being performed at Service Centers utilizing the Federal Conversion Support Center (FCSC) guidelines. The study results showed that over 90% of the approximately 3,000,000 lines of code in the inventory of software were American National Standard (ANS) 74 COBOL. Based on this fact, and the availability of automated tools, we envision approximately 12 months worth of effort at a projected cost of $9,500,000.

SENATOR ABDNOR: Who will be responsible for testing the CEPS systems offered by contractors? Is IRS now developing test data for CEPS? How much time does IRS intend to allow for testing the programs and optimizing them? How will IRS ensure that the converted programs function as intended and are fully tested before being implemented at the service centers?

MR. EGGER: All proposed systems that meet CEPS mandatory requirements shall undergo benchmark testing. We are in the final stages of benchmark test preparation, which includes all test data to be used in the benchmark tests. The benchmark is composed of a subset of currently existing SCRS programs that vendors must convert to run on their proposed equipment. To pass the benchmark tests, the vendors must successfully convert these programs, the converted programs must run correctly during the benchmark testing, and they must meet the performance requirements.

Upon contract award, the winning vendor will begin converting the SCRS software according to the conversion schedule as stipulated in the RFP. Prior to providing the software to the vendor for conversion, IRS will compile the SCRS source programs and run them using the SCRS test data files. The SCRS test data files are used yearly by the IRS to test the SCRS system to ensure that all changes made are correct prior to installing the programs in the Service Centers for use. IRS will run this test to ensure that the SCRS programs given to the vendor are correct. After the vendor has converted the programs and tested them using the SCRS test data, they will be delivered to IRS, as scheduled. IRS will then run the converted programs, using the SCRS test data, to determine if they are correct.

Upon completion of conversion of all SCRS software, Systems Acceptance Testing (SAT) will be accomplished to ensure that all programs will operate together correctly. SAT testing will start July 1988, and be completed by January 1989, a period of 6 months.

Additionally, prior to installing the converted software in the Service Centers, a pilot test will be conducted at one Service Center in an operational environment to ensure correctness. Upon completion of approximately three months of successful operation at the pilot center, phased implementation will begin at the remaining centers.

All optimization techniques used in the benchmark must be employed by the Contractor in the conversion. Further optimization will be accomplished by IRS following successful completion of the tax season.

SENATOR ABDNOR: Is IRS developing a contingency plan in case substantial conversion problems occur? For example, will IRS keep the current Sperry system running in parallel with the new system until that system is fully tested?

MR. EGGER: The contingency plan for CEPS calls for continued use and support of the SCRS hardware and software in the event that problems occur which delay implementation of CEPS as scheduled. This, then, provides a fallback system on which tax processing can be accomplished in a constrained manner. Once the CEPS system has successfully undergone all testing, phased implementation will be effected. Maintenance of SCRS applications software will cease after successful conversion in all Service Centers.

SENATOR ABDNOR: In what year does IRS expect to replace CEPS and will this replacement require another software conversion?

MR. EGGER: CEPS will be the cornerstone for TSR under the new evolutionary direction that TSR has taken. The CEPS will provide for ADP resources through 1997. What type of evolutionary conversion will be involved for TSR can not be determined at this time.

REALTIME INPUT SYSTEM (RIS)

SENATOR ABDNOR: To improve returns processing efficiency and responsiveness to the public, we understand IRS has initiated a development project called the Realtime Input System (RIS). The project's objective is to integrate, within a single system, logically associated returns processing functions. For example, this system will combine the input, error corrections, and final processing of return data. Currently these functions are split between two separate systems.

To implement this new system, we also understand that IRS is planning to acquire 11 IBM-compatible CPU's and necessary peripherals to replace the current hardware at all 10 service centers and the National Computer Center (NCC). Originally IRS had planned to issue a Request for Proposals by January 1985 and to award a contract by November 1985. However, we understand that IRS is considering delaying or cancelling the project.

What is the status of the Realtime Input System? Why has the project been delayed and/or cancelled? What does IRS plan to do as a result?

MR. EGGER: The Realtime Input System (RIS) initiative has been cancelled. The timing of the implementation of RIS was such that it coincided with the major initiative of the Capacity Enhancement for the Processing System (CEPS). After a thorough review and analysis we determined that the nearly simultaneous implementation of two significant initiatives would create too great an impact, and therefore, too great a risk to the tax processing system.

Since CEPS will remove workload from the existing Service Center Sperry systems, we will be able to keep the applications which would have been moved to RIS on the Sperry equipment. However, in approximately two years we must begin an initiative to replace the Sperry equipment due to growth and obsolescence, much as RIS had anticipated. Any such procurement must, of course, fit in with the overall strategy of the Tax System Redesign (TSR).

TAX SYSTEM REDESIGN

SENATOR ABDNOR: IRS established a Tax System Redesign Project (TSR) to address critical tax processing system-design issues and develop an acquisition strategy for a redesigned or new tax processing system that will support IRS' workload into the 21st century. Under TSR, IRS will study and consider state-of-the-art ADP concepts that could result in fundamental changes in how tax returns are processed. All current and interim ADP systems may be affected or replaced. IRS estimates TSR would help it collect billions in additional revenues.

In commenting on why TSR is needed, IRS notes that the architectural design of its computer systems is that of the 1950's, although it has added subsystems and new computer equipment to meet its ever-increasing workload demands. It also notes that many parts of its processing system are manual, requiring large amounts of human resources, particularly during tax filing season when many temporary employees are added. IRS anticipates that while substantial savings can be achieved from a redesigned system, the redesign would involve major system changes.

One major change being considered is the conversion of IRS computer programs to a higher level (fourth generation) language. The computer programs IRS uses to process its master file of information on individuals and businesses are written in assembler language. IRS would convert these programs to a language in which it is easier to revise the programs as needed. Such ease of maintenance is important given the frequent changes that are made to these programs when new tax laws are written or whenever IRS wishes to revise them to meet its changing needs. Assembler language is also machine- dependent, which means it will be more difficult and costly for IRS to convert to other computer systems in the future.

Several other improvements are planned under TSR. For example, IRS is considering using newer methods of data storage, i.e., instead of storing its information on approximately a quarter of a million computer tapes; it could store it on various types of disk storage devices. Under TSR, it also intends to convert to a more efficient structure for its numerous data files.

All of these proposed conversions are major undertakings, requiring careful planning. Treasury recently rejected IRS' proposed acquisition strategy for TSR. It noted the massive system changes being considered under TSR, and said that IRS needed to state TSR objectives in more detail.

What are IRS original and latest estimated milestone dates for TSR? Does IRS plan to make major changes to the objectives or scope of the TSR project?

MR. EGGER: As a result of Treasury's feedback, TSR will no longer be a project with milestones based on acquiring a redesigned tax system. We will pursue a redesigned computer-based tax administration system through several initiatives that have been incorporated into our current (FY 88 - 92) Information Systems Plan (ISP).

I have attached a copy of the original Tax System Redesign milestones as submitted to Treasury on October 7, 1985. In comparison, our revised objectives (Master File Modernization, Electronic Filing, Digital Archival Storage of Tax Information, and Image Technology for Tax Return Processing) begin in Fiscal Year 1986 and extend through the various cycles of system development and implementation into Fiscal Year 1997.

SENATOR ABDNOR: Does IRS intend to convert its current master file programs to a higher level language, and, if so, when?

MR. EGGER: Yes. The Service intends to convert the current master file assembly language programs to a higher level language. Development of a Software Conversion Plan will begin in Fiscal Year 1986. A fully parallel pilot of the converted Individual Master File segment is scheduled for Fiscal Year 1992. We anticipate a parallel pilot of an on-line Individual Master File segment in Fiscal Year 1994. Other segments will follow the same systems development cycle beginning with parallel pilots of the converted files and progressing through an on-line parallel pilot. Our goal is to provide an on-line data base of the Master File for use by appropriate functions by Fiscal Year 1997.

SENATOR ABDNOR: Has IRS developed a plan for how this software conversion would be done? Would these changes be phased in; and, if so, over what period of time?

MR. EGGER: Tax System Redesign intends to develop a Software Conversion Plan in conformance with the Federal Information Resource Management Regulations. Development of the Software Conversion Plan will begin in Fiscal Year 1986. This conversion plan will explore the phased in approach as well as other implementation methods.

We anticipate that these essential system changes will require that the task of software conversion, parallel pilot operations and implementations of the Master File Modernization effort be accomplished in phases. Current plans are to begin the application program conversion of the Individual Master File segment in 1990. We will conduct a fully parallel pilot of the decentralized batch Individual Master File segment in Fiscal Year 1992. The phased conversion effort will continue with the other Master File segments through Fiscal Year 1996. Our ultimate goal is to provide an on-line data base of the Master File for use by appropriate functions by Fiscal Year 1997.

SENATOR ABDNOR: Has IRS studied how it will convert to a new means of data storage or a new data file structure? When would such a conversion take place?

MR. EGGER: Tax System Redesign plans to begin the Master File Modification Requirements Analysis in Fiscal Year 1986. The Requirements Analysis will address alternatives of converting the current methods of storage and structure to new data file structures and storage methods, and make recommendations for acquisition/implementation.

Because of the complexity and magnitude of the Master File Modernization effort, the Service anticipates the Requirements Analysis recommending a phased and modular conversion approach. Our Fiscal Year 88-92 ISP milestones project beginning of file structure design in Fiscal Year 1988 and conversion of the Individual Master File segment programs in Fiscal Year 1990.

A fully parallel pilot of a portion (segment) of the Individual Master File's new storage and file structure will be conducted in Fiscal Year 1992. The phased modular approach of program conversion, parallel pilot and implementation of the remaining master file segments will continue through Fiscal Year 1996. Our goal is to have an on-line expanded Master File for use by appropriate functions by Fiscal Year 1997.

SENATOR ABDNOR: How is TSR being coordinated and integrated with the other numerous current and proposed procurements, such as CEPS, IDRS, and RIS to ensure they fit together and meet IRS' needs? Has a study been prepared outlining IRS' user needs and how each proposed system meets those needs without duplicating other systems?

MR. EGGER: There will be no longer a specific project identified as Tax System Redesign. However, the Office of Assistant Commissioner (Tax System Redesign) will become a fully functioning Assistant Commissioner with the responsibility to pursue a redesign of our computer-based tax system through several specific and separate initiatives. While these specific initiatives are still in the formative stages the most significant one requires the modification of the existing Master Files system into a system that contains the core of tax information that other tax processing or related functional systems will reference. In support of the Master Files Modification initiative and other such initiatives, the Assistant Commissioner (Tax System Redesign) will establish a more intensive data administration program. This program will be designed to manage data based on user needs, sharing and accessibility. Through this program the benefits of avoiding data duplication, improved systems interconnection, and systems development and integration standards will evolve.

SENATOR ABDNOR: Under TSR, major long-term communications changes, such as the use of communications satellites, are to be considered. A 1985 evaluation of IRS' ADP systems by Electronic Data Systems Corporation stated that IRS lacked direction on data communications and that a strategic plan was needed. A follow-up review by IRS staff agreed that IRS needed to better define communications responsibility. Is IRS preparing a strategic plan for communications? If so, will this plan integrate IRS' communications and ADP needs?

MR. EGGER: The Service's communications strategy is tied directly to the overall Treasury plan for communications. It will result in a network which can meet all of our voice, data, and office automation communications needs. This network will be integrated, in that it will carry both voice and digital data. Voice messages will be digitized, so that they can be handled in the same way as data.

The Service has been designated as the Executive Agent for the Department in developing the voice portion of this network. This involves providing nearly 300 digital automated private branch exchanges at key locations throughout the Department. These digital PABX's will handle local communications and, most importantly, digitize voice messages so that they can be handled using the most efficient and advanced communications technology. Special switches will be used to interface the resulting local nodes with the backbone data network being developed by the Bureau of Customs under another Executive Agreement.

The Service does have a long range plan which integrates both ADP and communications needs. It is called the Information Systems Plan (ISP). This plan establishes overall Service objectives and strategies for information systems and serves as the basis for development of the ADP portion of the Service's budget.

OPTICAL CHARACTER RECOGNITION

SENATOR ABDNOR: IRS is using two optical scanning systems to process such forms as Federal Tax Deposits, 1040EZ tax returns, and information documents (1099s, 5498s). Although the scanners appear to speed processing, the poor quality of some vendor-supplied documents and the failure of some taxpayers to accurately fill out the documents has decreased the efficiency of the scanners.

What steps has the IRS taken to educate taxpayers in completing scannable documents? What have been the results of these measures?

MR. EGGER: The IRS had included stuffer notices with quarterly employer tax returns sent out to taxpayers instructing them in the correct way to fill out the FTD coupons. In November 1985, the coupons themselves were revised to highlight important instructions as well as making them easier to complete. Taxpayers ordering coupons after November and all new filers will receive the revised coupon and instructions.

Form 1040EZ instructions for 1985 emphasize the importance of entering legible numbers precisely within the boxes. Also, taxpayers are strongly encouraged to use preprinted labels in submitting their returns. Only Forms 1040EZ with preprinted labels (without address changes) can be processed by OCR. Last year, 55.2 percent of Forms 1040EZ for 1984 filed used preprinted labels and 36 percent of all Forms 1040EZ received nationwide were scannable.

The 1985 instructions for Forms 1099, 1098, 5498, 1096 and W-2G were clarified. The 1986 instructions will specifically state that a penalty for failure to file scannable returns will be assessed. Two news releases have also been issued on this topic. Results cannot be assessed at this time.

SENATOR ABDNOR: Do penalties exist for failure to file processable documents? If so, have they been assessed? What are the results?

MR. EGGER: No such penalties exist for FTD coupons which cannot be processed. However, a $50 penalty per unscannable information document is in place.

The first year for assessment of the penalty is 1986 for documents filed for 1985. Results are unknown.

SENATOR ABDNOR: Is there a program in place to follow up on payers who submit poor quality documents?

MR. EGGER: In January 1986, the IRS began sending letters to taxpayers to advise them that their FTD coupons were not completed properly. A similar procedure is in place for information documents which are incorrectly prepared. If payers do not respond within 30 days of contact, the $50 per document penalty will be proposed.

SENATOR ABDNOR: What initiative, if any, are underway or planned to improve the efficiency of the scanning systems (e.g., MICRO encoding FTD coupons)?

MR. EGGER: MICRO encoding is done on a voluntary basis by the banks. It is being pursued locally with efficiency based on the sophistication of the banks involved.

Furthermore, we plan to have microfilm capability to record every transmittal document (Form 1096/W-3G). This would enable our service centers to stop sorting, editing, separating, and storing these forms (approximately 5 million annually). This will save us over $100,000 per year.

SENATOR ABDNOR: What controls are in place to ensure that all information being scanned is done so correctly?

MR. EGGER: The IRS developed quality review procedures for each phase of the scanning process. This review is performed on a sample of the documents. Test documents are also run routinely in the service centers with feedback provided to the OCR vendor for analysis and corrective actions.

Forms 1040EZ containing illegible entries unrecognizable to the OCR scanner are key entered by terminal operators. Any unresolved errors resulting from validity checks during the scanning phase are corrected in the Service Center Error Resolution.

For information documents, all identification numbers (payer and payee) and money amounts are being key verified to ensure correctness. A post-edit process further ensures that information generated is correct and in acceptable format prior to leaving the OCR system. Form 8264, Application for Registration of Tax Shelter, another scanned form, is subject to various validity and consistency checks to identify incorrectly scanned data. Data not recognized by the scanner is identified for manual entry.

SENATOR ABDNOR: What back-up systems are in place to process FTDs, 1040s, and IRP documents should one of the two OCR systems be rendered inoperable?

MR. EGGER: FTD coupons, Forms 1040EZ, Forms 8264, Application for Registration of a Tax Shelter, and most IRP documents can be processed through the Distributed Input System. IRP documents can also be transhipped from center to center for processing.

SENATOR ABDNOR: What is the status of the OCR remittance processing system? Does IRS plan to extend the use of that system Servicewide?

MR. EGGER: Funding for the OCR remittance processing system was lost during budget review. OCR technology will be included in our effort to replace the entire remittance processing system in all of the service centers.

SENATOR ABDNOR: What plans are there to further utilize OCR technology at the service centers?

MR. EGGER: OCR technology will be utilized in the remittance processing system scheduled for 1988/1989.

We are in the preliminary stages of pursuing OCR technology for Forms 6248, Annual Information Returns of Windfall Profit Tax, at our Austin Service Center beginning in 1987. We are also exploring the feasibility of using OCR for processing transmittal Forms 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, as well as Forms 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, at the Philadelphia Service Center beginning in 1988.

We plan to scan Forms 941 (Employer's Quarterly Tax Return) and 942 (Employer's Quarterly Tax Return for Household Employees). The 941 application is scheduled to be tested in July 1986 at our Andover Service Center with nationwide implementation planned for January 1987. We do not have a definitive timetable for the 942 at this time.

We also plan to scan Form 1120A, U.S. Short-Form Corporation Income Tax Return. Testing will begin at the Cincinnati Service Center in April 1986, with the pilot being conducted in May, June and July. A nationwide implementation date has not been scheduled at this time.

INFORMATION RETURNS PROGRAM

SENATOR ABDNOR: In recent years, legislation, namely the Interest and Dividend Compliance Act of 1983 (P.L. 98-67), has served to expand the scope of IRS' Information Returns Program. Approximately 510 million non-wage (interest, dividends, etc.) information documents and 180 million wage (W-2s, etc.) related documents were received by IRS for tax year 1983 on paper and magnetic media. In addition, IRS annually receives over 10 million schedule K-1 (conduit) information returns, which record individual partner or investor income for partnerships, trusts, etc. The volume of non-wage information is expected to grow further over the next several years thus providing IRS with more income data than it has ever possessed.

How many non-wage information documents has IRS received for tax year 1984? What are the projections for tax years 1985 and 1986?

MR. EGGER: Last year we received almost 609 million non-wage information returns for 1984 income. We have projected receipts for 1985 and 1986 non-wage information returns to be 637 million and 702 million, respectively.

SENATOR ABDNOR: What percentage of tax year 1983 and 1984 non-wage documents were used in the matching program? Why were certain documents not used? Are business information documents used? If not, why not?

MR. EGGER: We processed 91% of tax year 1983 non-wage documents and 92% of 1984 non-wage documents. I believe we show almost 99% of all documents processed in FY 1985 on page 14 of the IRS Budget Estimates for 1987. I'd like to correct that for the record, if I may. That chart should show 794 million information returns received and 747 million processed.

Now, aside from business information returns, which I will address in a moment, the only information returns we don't process all the way through to matching with tax returns are those with bad data or missing social security numbers. During initial processing of magnetic media receipts from payers, we do identify "bad data", that is, missing or incomplete data fields and obvious problems such as letters or numbers in inappropriate fields. We also can drop documents up until the last minute when payers discover mistakes and inform us in time. When we find such errors, we inform the transmitter, and the payer is responsible for filing corrected documents which we do use.

As for information returns with business payees, there are several problems which prevent us from developing a computerized match. More often than not, businesses use accounting periods other than the calendar year covered by information returns. They also may use either a cash or accrual accounting method and have substantial earnings from sources not required to file information returns. Thus, matching information returns with tax returns for businesses becomes too complex for a computerized process.

SENATOR ABDNOR: To what extent are information documents not used because they were unprocessable. How many penalties were assessed in tax years 1982, 1983, and 1984 against filers of unprocessable documents? Will these penalties be fully enforced for tax year 1985 information documents?

MR. EGGER: Approximately four percent of the information returns we have received in the past were totally unprocessable. We have not yet assessed penalties, but we will start penalizing payers this year for improperly prepared information returns. All paper documents must be scannable. Also, all submissions in excess of fifty 1099's for interest, dividends, original issue discount, patronage dividends, or sales of securities and commodities must be on magnetic media. Otherwise, we will correspond for corrective action and assert penalties for non-compliance in lieu of reasonable justification.

SENATOR ABDNOR: To what extent were conduit information returns processed and used in the matching program for tax years 1982, 1983, and 1984? How much revenue is accounted for by these documents?

MR. EGGER: Each year we select approximately 20 percent of conduit information returns for matching. We only have preliminary figures for 1982 which shows about three and a half million dollars assessed in tax and penalties for unreported conduit income. The total is unquestionably higher, but an unknown amount is combined with assessments from other unreported income and, thus, we can't break it out for you.

SENATOR ABDNOR: Of the documents not used in the matching program, what percentage were subject to backup withholding? What mechanisms has IRS established to administer and enforce backup withholding?

MR. EGGER: We don't have any information on the number of taxpayers subject to backup withholding due to problems with their identifying numbers. As of the third quarter of last year, however, there were over 14,000 payers withholding on accounts of payees who did not have or had not provided identifying numbers.

Backup withholding is required of payers when they cannot obtain an identifying number for a payee who is required to have one. Failure to do so makes the payer subject to a $50 penalty for each instance.

Backup withholding also applies to individuals who fail to report interest and dividend income and subsequently fail to pay the tax owed. We identify these individuals during routine examinations starting with 1984 returns, as a result of a contact in our underreporter program, or in the delinquent return programs. These taxpayers receive at least four notices telling them what they must do to resolve the condition and what will happen if they fail to do so. If they do not, the Service will inform their payer to withhold 20 percent. This will remain in effect for one year with a review of all such cases annually on October fifteenth. Those unresolved at that time will continue another year. This process has not progressed far enough for any taxpayers to be subjected to it yet. The first withholding will probably occur in FY 1987.

SENATOR ABDNOR: With IRS now using more of the paper information returns it receives and magnetic media accounting for more and more documents every year, the service should be in a position to develop a Payer Master File (PMF) which is quite extensive. The PMF can be used to foster compliance by identifying those payers who may not be providing IRS with third party income information. IRS' experience has been that when a payee receives a copy of the information return filed by the payer, the recipient is more likely to report that income on his or her return.

What is the current status of IRS' effort to develop an effective PMF and PMF program?

MR. EGGER: We have developed a payer stop-filer program which will compare current information return filings for each payer with that payer's previous year and a nonfiler program which will analyze other master files to identify entities which appear to be liable for filing information returns. We will also have the capability, as of May 1986, to post waivers for not filing on magnetic media and extensions for late filing of information returns, as well as the Form 8210 for Self-Assessed Penalties.

We have encountered processing problems with the transmittal documents that are at the core of the PMF. We will not solve this problem in time to use transmittal documents for 1985, but we will be able to process the 1986 transmittals next year. Then we will resume the nonfiler check for 1986 transmittals in 1988 and the stopfiler check in 1989. The timing of the stopfiler check is staggered because we base that analysis on the prior tax year history--in this instance that means 1986--and because processing time for the 1987 transmittals runs through the end of FY

1988. So, the 1987 stopfiler check won't occur until early 1989.

SENATOR ABDNOR: How does the IRS envision using the PMF as a compliance tool?

MR. EGGER: In addition to the payer compliance programs I just mentioned, the PMF will be used to generate penalty notices for late filing of information returns and for not filing on magnetic media when required. These will commence in June 1986.

SENATOR ABDNOR: Last year IRS stated that by fiscal year 1987 it would be able to follow-up on virtually all Information Returns Program cases with a balance due. Is this projection still valid? If so, what is the projected workload through fiscal year 1987?

MR. EGGER: With the resources requested in this budget we do expect to follow-up on virtually all non-filer and most underreporter balance due cases identified through the matching program. I have qualified that for the underreporter cases because we are going to great lengths to ensure a quality program. Naturally, this is having an effect on the cost of that program so we cannot guarantee the projected volume for FY 1986 of four and a quarter million contacts. The total may be somewhat under four million due to the emphasis we are placing on improving the quality. We are currently in the middle of that program, we recognize that the cost of quality will have an impact, but we are not yet prepared to recast the numbers for FY 1987.

So, the projections for underreporter follow-up now would be around 4 million contacts for FY 1986 and up to 5.5 million in FY 1987 with the additional staff we are requesting and with the stabilization of rates following this quality initiative.

For non-filers, we expect to close 325,000 cases requiring follow-up beyond the notice stage for FY 1986 and 342,000 cases in FY 1987.

SENATOR ABDNOR: Will increases in resources be required? If not, then specifically what has IRS done to streamline processing procedures? Will tolerance levels be increased to reduce the caseload?

MR. EGGER: Yes, we are asking for 677 average positions to increase follow-up on underreporter cases in FY 1987. As far as streamlining procedures, we are studying enhancements to the current system that will automate some manual processes and eliminate some clerical functions. In the future, we are planning on implementing a fully automated underreporter system that would provide most data, except the tax return, needed to resolve the case on a computer terminal and would eliminate a separate data transcription process now used to issue underreporter notices.

We have also implemented a new process in the nonfiler program whereby the service prepares a tax return based on income on information documents when taxpayers are not responsive to delinquency notices and phone calls. We do this, which includes correspondence through registered mail, rather than sending out a revenue officer.

On the question of tolerances, when we limit caseload we try to gear our selection to categories where we get the most bang for our bucks rather than to a strict tolerance.

SENATOR ABDNOR: To what degree, if any, have improvements in ADP systems assisted in streamlining the processing procedures?

MR. EGGER: Well, we have implemented optical character recognition, or scanning, equipment in all ten service centers as of last year, but we have also streamlined processing of magnetic media receipts. Now all transmitters who file on magnetic media send their files to the National Computer Center rather than to the service centers. So, we have consolidated that process as well as the personnel who assist and respond to payers and their problems.

SENATOR ABDNOR: Beginning January 1, 1985, the responsibility for the coordination of all information documents received by IRS on magnetic media was moved to NCC. Transmitters of information on magnetic media now send the tapes directly to the magnetic media group at NCC rather than to one of the ten service centers. With respect to this organizational shift:

What occurs in those instances in which a transmitter corrects or updates a previously submitted tape using paper documents? Does NCC have the resources and equipment to properly transcribe the paper documents to magnetic tape?

MR.EGGER: As a point of clarification, as of January 1, 1985, responsibility for coordination of information documents formerly received by only the Austin, Kansas City, and Philadelphia Service Centers was moved to NCC. Full responsibility for all information documents for the entire country was not moved to NCC until January 1, 1986.

In those instances in which a transmitter used paper documents to correct or update records previously submitted on magnetic media, the paper documents must be filed with the appropriate service center -- not NCC. NCC does not have the equipment or resources to scan and/or transcribe paper documents to magnetic media. The paper documents are processed through the service center, converted to tape and transmitted to NCC to be input to the mainline Information Returns Program system. During that IRP processing, the corrected records are asociated with the records originally filed on magnetic media.

SENATOR ABDNOR: With the magnetic media function now at NCC, what type of outreach or assistance programs have been established to deal with transmitters who may have technical questions on tape preparation, etc.?

MR. EGGER NCC has developed a new organization component to provide service and technical assistance to magnetic media filers. Personnel from this Information Returns Branch traveled extensively in the fall of 1985 and conducted 62 Magnetic Media Seminars. These seminars had total attendance in excess of 4,500 individuals representing several hundred payer institutions. In addition, presentations were made to various state banking associations and annual conferences of software houses and so forth. We intend to continue these seminars wherever a need for them surfaces.

SENATOR ABDNOR: To what degree have transmitters been using the programs to deal with NCC on problems and questions that have previously been handled by their local service center? Has there been a noticeable difference in the quality of the tapes received at NCC?

MR. EGGER: Aside from the seminars, we received a considerable number of calls as the filing deadline approached in February. During one week, we received 500-600 calls per day on the twenty phone lines we have available for filers. At this point, though, it is too early to tell about improvements in the quality of receipts. We receive a massive volume in a very short time and process those tapes over several months. We are currently in that process.

SENATOR ABDNOR: Are magnetic tapes containing information returns still being inadvertently sent to service centers rather than NCC? If so, how many IRP magnetic tapes have been sent to service centers since January 1, 1985, and what procedures have been established to assure those tapes are forwarded to NCC?

MR. EGGER: I'm sure some were mistakenly sent to service centers, but we don't keep reports on that. When service centers receive such tapes they routinely forward them to NCC.

SENATOR ABDNOR: As a result of the Interest and Dividend Tax Compliance Act of 1983 (P.L. 98-67), IRS expanded the document matching program for interest and dividend income beginning with tax year 1983. However, because of recent tax return processing problems, some service centers apparently had to reduce the number of cases they received.

Did IRS' service centers, in fact, have to cut back the scope of their Information Returns Program review? If so, which ones did so and why?

MR. EGGER: As I mentioned a minute ago, the number of underreporter cases to be resolved in the 1986 fiscal year is going to be less than anticipated due to our efforts to ensure the quality of that program. This is going to be felt in all service centers.

SENATOR ABDNOR: What effect did cutting back the number of cases reviewed have on revenue collected by the various centers?

MR. EGGER: Well, we don't have estimated of assessments for each service center, but the short-fall will be in the range of about seventy-five to one hundred million dollars.

FILES ARCHIVAL IMAGE STORAGE AND RETRIEVAL SYSTEM

SENATOR ABDNOR: IRS has been evaluating available technology which would permit the rapid storage and retrieval of tax returns. One such project, known as the Files Archival Image Storage and Retrieval System (FAISR), relies on laser storage technology to convert tax returns to digital images which can be stored on laser disks and retrieved on high resolution terminals.

Although a test system was installed in the Fresno Service Center for a system acceptability test beginning August 5, 1985, IRS has experienced problems with the system which have precluded completion of the test. In particular, IRS has been unable to secure a sufficient number of laser disks to permit the initiation of the testing.

What is the current status of FAISR?

MR. EGGER: The president of Alcatel Thomson Gigadisc, the French manufacturer of the optical disks used in FAISR, has been contacted by the U.S. trade representative in Paris. This contact was initiated by IRS through the Department of Commerce and resulted in a commitment from

Thomson for delivery of enough disks to begin testing FAISR in August, 1986.

Because of concern about Thomson's ability to keep their commitment, IRS is currently negotiating with the FAISR vendor for an equipment exchange which would result in a system that can utilize both Thomson and other optical disks. This would allow the research test to begin in August even if a limited number of Thomson disks are delivered on schedule.

SENATOR ABDNOR: Describe the problems IRS has experienced with the system? What corrective actions have been taken or planned? What options exist to allow IRS to complete the system acceptability test?

MR. EGGER: Lack of optical disk media is the major problem IRS has experienced with the system. The FAISR vendor experienced hardware problems with components supplied by subcontractors, and software problems with code they developed themselves. IRS has taken corrective action to remedy these problems. We are negotiating for an exchange of equipment that will permit the use of optical disks that are commercially available in quantity. We have met with the vendor to determine solutions to problems. We have reviewed the vendor's plans for corrective action and are monitoring progress. Negotiations are in progress to resolve remaining contractual issues to permit system acceptability testing to begin in August.

SENATOR ABDNOR: Does IRS still consider FAISR to be an interim solution to its filing storage and retrieving problems, or has technology advanced sufficiently at this time so that FAISR should be incorporated as part of the Tax System Redesign Project?

MR. EGGER: IRS still considers optical disk technology as having the potential to solve our storage and retrieving problems. Our experience suggests that the capability of this technology extends beyond storage and retrieving to other processing activities. We are considering making enhancements to FAISR to test this premise.

CRIMINAL INVESTIGATION RESOURCE ALLOCATION

SENATOR ABDNOR: IRS' Criminal Investigation Division (CID) investigates violations of the federal tax laws and related offenses and identifies areas of willful noncompliance and the methods used to circumvent the tax laws.

In fiscal year 1983 through 1985, CID divided its investigative time almost equally between cases that involved legal source income, such as unreported income from tax protesters, and cases that involved illegal source income, such as drug trafficking.

What is the basis for the equal distribution of CID resources between these two areas?

MR. EGGER: Criminal Investigation strives to maintain a balanced enforcement effort through the General and Special Enforcement Programs in support of its mission to achieve the highest degree of voluntary compliance with Internal Revenue laws. The national areas of emphasis in the General Enforcement Program (GEP) are the Questionable Refund Program, Tax Shelter Program, Tax Haven/Offshore Banks, and the Illegal Tax Protester Program. Emphasis areas in the Special Enforcement Program (SEP) are narcotics traffickers/financiers and major organized crime figures.

The percent of direct investigative time devoted to each of these programs is determined by the Assistant Commissioner (Criminal Investigation) prior to the beginning of the fiscal year. These decisions are based on field input as well as National Office management decisions on where resources should be applied to identify and investigate high impact cases. These cases of substance are expected to achieve the maximum effect for achieving voluntary compliance.

The direct investigative time applied to the two programs has not changed significantly during the last three fiscal years. In FY 1983, 54 percent of the direct investigative time was applied to GEP and 46 percent to SEP. In FY 1984 and FY 1985, 53 percent of direct investigative time was devoted to GEP and 47 percent to SEP.

SENATOR ABDNOR: How are CID's investigative priorities established within these areas? How much emphasis is placed on external considerations such as Administration or Congressional priorities, when formulating CID's strategy?

MR. EGGER: Criminal Investigation employs the "grass roots" approach to determine how resources will be utilized by the field. Prior to the beginning of the fiscal year each district and region develop program objectives which are tailored to their respective long range compliance needs and are in keeping with the national emphasis areas. The District program objectives are consolidated into a Regional program letter and furnished to the Assistant Commissioner (Criminal Investigation) for concurrence. The guidelines are discussed at an annual meeting with the Assistant Regional Commissioners (Criminal Investigation), and the approved program guidelines are issued in IRM Part IX, Criminal Investigation. These program objectives specify the broad national objectives for the fiscal year for the entire function. Each Assistant Regional Commissioner (Criminal Investigation) has the responsibility to determine what specific work goals are to be achieved as well as manage the resources.

Criminal Investigation does consider Administration and

Congressional priorities in formulating its strategy. In FY 1985, Congress allocated additional resources to allow Criminal Investigation to participate in the Organized Crime and Drug Enforcement Task Forces. These staff years remain in SEP and are not taken into consideration when the resource allocation formula is prepared for the upcoming budget years. Because staffing in Criminal Investigation has remained relatively static for the past several years, the resource allocation formula has been implemented only to the extent attrition permits. Further, this delay has impacted negatively in the effective implementation of the "grass roots" program letter approach.

SENATOR ABDNOR: Has IRS made significant inroads in the illegal source income area? Can IRS cite specific tax related accomplishments? What problems hinder IRS from making further progress in this area?

MR. EGGER: IRS has made a significant contribution toward prosecuting those individuals who earn their income from illegal activities.

Investigations of this nature, include narcotics or narcotics related cases (High Level Drug Leaders Project and the Organized Crime Drug Enforcement Task Forces), illegal money laundering, Strike Force and wagering. These investigations are part of the Special Enforcement Program and the accomplishments are reflected in the following summary:

IRS - CID Special Enforcement Investigations

	FY 1983	FY 1984	FY 1985
Cases Initiated	2,009	2,104	2,458
Prosecution Recommended	1,091	1,361	1,541
Indictments Obtained	757	1,014	1,215
Convicted/Guilty Pleas	551	816	927
Percent to Prison	71%	69%	74%
Total Fines (Thousands)	6,176	8,044	8,299
Staff Years Expended	1,273	1,395	1,446

A brief analysis of the results in the Special Enforcement Program area reflects that since FY 1983, IRS has increased the resources allocated by 173 staff years, or 13.6%. During the same time, cases initiated increased from 2,009 in FY 1983 to 2,458 in FY 1985, (22.4%) and Prosecution Recommendations increased from 1,091 in FY 1983 to 1,541 in FY 1985, (41.3%). Indictments obtained increased 60.5% from 757 in FY 1983 to 1,215 in FY 1985, while those being convicted or pleading guilty increased by 68% from 551 in FY 1983 to 927 in FY 1985. The increase in staffing of only 13.6% correlates to a 68% increase in convictions during the same time period.

In addition, narcotics related assessments have increased substantially from FY 1983 to FY 1985. In FY 1983, these assessments were made on 260 narcotics investigations totaling $68.8 million dollars for an average of $264,615 per assessment. This increased in FY 1985 to a total of $244 million on 296 cases for an average of $824,324.

Jeopardy assessments are made when IRS finds that the collection of income tax is in jeopardy after the due date for filing a tax return has passed. Termination assessments are made when the IRS finds that the collection of income tax is in jeopardy before the end of the tax year.

IRS is primarily hindered from making further progress in the investigation of individuals deriving their income from illegal sources because further emphasis in the special enforcement area would necessitate a reduction in other areas of emphasis. The commitment of resources in FY 1985 to all such Special Enforcement Programs represented 47% of total direct investigative time expended.

The remaining 53% was expended in the General Enforcement Program, which includes investigations of promoters of abusive tax shelters and individuals in the illegal tax protester movement, etc.

SENATOR ABDNOR: Is there evidence to show that criminal elements have been deferred from tax law noncompliance as a result of CID investigations into illegal source income activities?

MR. EGGER: As with prosecutions by any law enforcement agency, it is difficult to quantify the deterrent effect of IRS criminal investigations and prosecutions. Although IRS does not maintain any statistics that would directly reflect the deterrence for criminal elements, we do know that many high level organized criminal figures and narcotics traffickers are reporting substantial "miscellaneous" income in order to avoid problems with the IRS.

In the Title 31 area, the deterrent effect that the successful prosecution of a major Boston bank in February 1985 as well as other cases have had on the filing of Currency Transaction Reports, Form 4789, has been dramatic. In calendar year 1983, a total of 513,782 CTR's were filed with the IRS. This increased in calendar year 1984 to 707,246. In calendar year 1985, immediately following the prosecution of the Boston case, CTR filings with the IRS increased significantly. A total of 1,832,000 CTRs were filed with the IRS in calendar year 1985, a 256% increase over the prior year.

SENATOR ABDNOR: What tools are needed to make CID more effective in addressing the illegal source income problem?

MR. EGGER: Two specific areas where legislative changes would make IRS more effective in addressing illegal source income are:

Forfeitures - Titles 26 and 31 should be amended to expand forfeiture authority for all laws administered by IRS, including Title 31. Further, increase the dollar amount for administrative forfeitures to $100,000, and correspondingly increase the bond to contest forfeitures.

Amend Rule 6(e) of the Federal Rules of Criminal Procedure to allow the Service, within proper safeguards, to obtain and use information involving matters occurring before the grand jury for civil tax assessments (Also see the response to the specific question relating to the Baggett decision and reference to the Service's statement filed with the Senate Judiciary Committee supporting S.1676.)

UNDERCOVER OPERATIONS

SENATOR ABDNOR: Undercover operations are an important investigative tool for IRS. According to statistics obtained from IRS' management information system, 230 undercover operations were approved in fiscal year 1985 at an approved funding level of about $2.2 million.

About 30 percent of these investigations involved tax shelters and another 25 percent involved money laundering activities.

What is the procedure for approving undercover operations?

Specifically, who approves most large undercover operations?

MR. EGGER: IRS undercover procedures, which were modeled after Senate Bill 804, are set forth in the Internal Revenue Manual (IRM). These procedures were developed by an IRS multifunctional task force and in cooperation with the Department of Justice. Prior to their being implemented they were reviewed by the American Bar Association.

Undercover activities are classified as either Group I or Group II operations. Group I operations require the approval of the Assistant Commissioner (Criminal Investigation). Group I operations are those that exceed 90 days in duration and/or exceed a Regional Commissioner's level of approval of $10,000 for confidential expenditures. In addition, an operation is classified as a Group I if there is a reasonable expectation that one or more of specifically enumerated IRM factors may be encountered.

Group II operations include all other undercover activities not meeting the requirements for Group I. Group II operations require the approval of the Regional Commissioner.

In submitting a request to conduct an undercover operation, a District Office must first obtain the concurrence and approval of both the Chief, Criminal Investigation Division, and the local District Director. Requests are then forwarded to the Regional Office for review and approval by both the Assistant Regional Commissioner (Criminal Investigation), and the Regional Commissioner.

Requests for Group I operations concurred in and forwarded by Regional Commissioners are first reviewed by the Undercover Review Committee at the National Office. This committee, is advisory in nature and includes a representative from IRS Chief Counsel, Criminal Tax Division, and recommends either approval or disapproval of the operation to the Assistant Commissioner (Criminal Investigation).

SENATOR ABDNOR: What controls exist to assure that undercover operations are conducted properly and within the law?

MR. EGGER: Specific procedures are set forth in the IRM for review and approval of all undercover operations. They include the designation of a Regional Undercover Program Manager who will, among other duties, provide support and assistance to all undercover operations in a respective region and conduct pre-operational meetings prior to the initiation of undercover activity. Duties, responsibilities, objectives, plan of action, administrative matters, and other items considered important are discussed. The usual participants at this meeting will be the undercover agent, contact agent, project coordinator, and/or case agent, group manager, Chief, Regional Program Manager, district counsel, Assistant U.S. Attorney, etc.

Undercover operations require the approval of either the Regional Commissioner or designee for Group II operations and the Assistant Commissioner (Criminal Investigation) for Group I operations. These approvals are usually after consultation with the offices of district counsel, regional counsel or the U.S. Attorney. In a Group I matter a review and recommendation by the Undercover Review Committee, which includes the Director, Criminal Tax Division, of the Office of Chief Counsel also is required. The various approval levels, as discussed above also would be necessary when any significant deviations from a previously reviewed and approved plan of action is proposed.

IRM procedures require that undercover agents receive specialized training in the use of this investigative technique. This is in addition to normal special agent required training. This training includes segments conducted by representatives of the Office of Chief Counsel, Criminal Tax Division and includes among other matters "do's and don'ts" for undercover agents, legal restrictions and prohibitions, etc.

The contact agent, who is usually a GS-12 or above experienced special agent, is in continuous contact with the undercover agent and ensures that the day to day matters concerning the undercover agent are attended to. The contact agent's duties also include arranging for meetings with the undercover agent and management for the review of the operation, including the agents performance and methods being utilized to achieve the operation's objectives. The IRM requires an on-site review of each Group I operation, at least every 90 days, by the regional office and with national office participation. The continuous review of an undercover operation ensures that the operation is conducted in an orderly and lawful manner. Review procedures also require the highlighting of significant, unusual events, or problems which may occur during an operation.

SENATOR ABDNOR: What type of information is typically obtained from undercover operations? How essential are undercover operations to the success of CID operations?

MR. EGGER: The evidence developed from an undercover operation goes directly to proving the intent and motive of those persons involved in the illegal activities. Direct evidence, obtained through the use of the undercover technique, is often the key to a successful prosecution. Such direct evidence has been the cornerstone of our success in money laundering operations and criminally abusive tax shelters. For example, in a money laundering investigation, we typically learn the source and volume of funds being laundered, and that they often are the proceeds of illegal narcotics trafficking. We also learn the reasons the funds are being secreted, the identities of corrupt financial institutions and their officers, both here and abroad, and the huge amounts of illegal monies that are being generated and paid to facilitate these laundering activities. We are able to develop detailed evidence of the crimes related to the money laundering activities from admissions made by the participants themselves, and evidence of the extent and sphere of the criminal organization's influence.

Undercover operations are vital to the successful investigation of money laundering activities. This has proven to be true in Operation Greenback and in other money laundering investigations undertaken by IRS. The technique has allowed IRS to successfully conduct money laundering investigations throughout the United States. Some of these investigations involve foreign countries/territories such as Hong Kong, Puerto Rico and Switzerland. Without the use of the undercover technique, the IRS could be greatly disadvantaged in the war against the sophisticated money launderers, the corrupt financial institutions and financial kingpins who permeate the world of narcotics trafficking.

Recently in the Services' efforts to combat fraudulent and otherwise illegal tax shelters two attorneys pled guilty to criminal charges stemming from their involvement in a nationally coordinated Shelter investigation. Special Agents of the Service's Criminal Investigation Division executed search warrants on promoters at eight locations throughout the U.S. and one site in the Virgin Islands.

These were the first two convictions resulting from this nationwide investigation, and other investigations are still in progress. Additional convictions involving promoters and investors are expected.

The Service's investigation has proven that this large scale enterprise was merely a sham created for the sole purpose of generating fraudulent tax deductions. Investigation indicates that the investors were fully aware that the promotion was in fact a sham.

In related actions a number of other individuals connected with the investigation have consented to injunctions barring them from any further promotion of the shelter scheme.

We have recently incorporated into our Management Information System the necessary mechanics to track our undercover activities from inception to conclusion, i.e. trial and adjudication; which will eventually afford us the opportunity to track the investigation to finality, including the assessment and collection of revenue.

STAFF ATTRITION

SENATOR ABDNOR: In some locations a significant number of CID special agents are leaving IRS to work for other law enforcement agencies that more readily offer 25 percent premium pay and use of a government car. We understand that this problem is most acute in IRS' Manhattan District.

What does 25 percent premium pay mean to a typical agent in terms of additional salary? What is the typical pay range?

MR. EGGER: Twenty-five percent premium pay for a year would be $6,003.00 in additional salary. Premium pay is computed as a percent of a GS 10 step one. The average grade of special agents is GS 12 step five or $35,835.00 annually.

In FY 1983 and FY 1984, the Manhattan District lost 10 percent of its special agent staffing to other federal law enforcement agencies, primarily to the U.S. Customs Service. In exit interviews the reasons most frequently cited for transferring were more premium pay and that there was a government car available for each agent.

SENATOR ABDNOR: When and how is premium pay awarded by IRS? Do other agencies award premium pay for circumstances that do not meet IRS' criteria?

MR. EGGER: Premium pay for administratively uncontrollable overtime is used when hours of duty cannot be controlled administratively, and which require substantial amounts of irregular or occasional overtime duty. Immediate supervisors of special agents are responsible for determining and recommending which special agents under their supervision shall receive premium pay and which of the allowable rates of premium pay is applicable. We do not know how other agencies award premium pay. The Internal Revenue Service administers premium pay in accordance with regulations and policies established by the Comptroller General, Department of the Treasury and the Service.

SENATOR ABDNOR: Is CID staff attrition a major problem? If so, how has it impacted on CID's ability to successfully investigate illegal activities?

MR. EGGER: For FY 1984 and FY 1985, CID special agent attrition was 5.7 and 6.5 percent, respectively. Attrition is only a problem in major cities during a time of reduced staffing and a freeze on hiring as we are in now. Most illegal activity investigations center around major metropolitan cities, thus, we have less special agents to work such cases. However, to directly respond to the question, Criminal Investigation staff attrition is not a major problem at this time.

COLLECTIONS RESULTING FROM CID ACTIVITIES

SENATOR ABDNOR: The law enforcement statistics cited for CID reveal an impressive number of arrests, convictions, sentences, and fines imposed. However, the statistics do not include information on additional tax revenues collected through CID activities.

Can CID cite the amount of federal tax revenue collected as result of its activities?

MR. EGGER: The Service does not presently track this information, however, the General Accounting Office is presently conducting a review of this area and they are planning on looking at the present management information systems of both Examination and Collection, the functions we normally categorize as being involved in direct revenue production. Helpful suggestions relating to the capacity to retrieve more data from these management information systems and coalescing the necessary data with Criminal Investigation's management information system should be forthcoming. A coordinated effort by all of the operations functions in cooperation with Planning and Research also should provide a better accounting than we now have.

However, we do maintain statistical data in some program areas that gives us approximate tax revenue collected figures and/or dollar savings to the government. One of these areas is the jeopardy assessments and terminations that resulted from our Narcotics Traffickers Program which totaled approximately $244 million for fiscal year 1985. Another figure captured is Taxes and Penalties resulting from CID Referrals to the Examination Division for Potential Civil Action which totaled approximately $30 million for fiscal year 1985. Finally, we capture the estimated criminal deficiencies figure from investigations that result in prosecution recommendations. This figure was approximately $245 million in fiscal year 1985.

Criminal Investigation operated two programs at IRS service centers designed to identify claims for fraudulent refunds either from individuals who file more than one valid return in a single tax year or who claim fraudulent deductions in connection with an abusive tax shelter. These two programs were responsible for stopping more than $20 million in fraudulent refunds from being issued during the 1985 filing season.

We have initiated a limited program within Criminal Investigation to capture this type data from undercover operations. Since undercover accounts for less than five percent of our total investigative efforts CID will be able to unilaterally initiate a program to retrieve this type data with the thought that eventually a broader program covering all Operations' functions will replace it.

We also believe, however, that it is important to state for the record that Criminal Investigation plays a role far beyond direct revenue production. For example, approximately five percent of total revenues collected are as a result of Examination and Collection efforts. This leaves approximately ninety-five percent of total revenues collected coming from the self-assessment voluntary compliance attitudes of the public. The deterrent effect of the Criminal Investigation activities falls within this ninety-five percent.

Many have commented that the estimated current voluntary compliance level of approximately eighty percent is due to the reduction in Examination coverage to 1.2 percent. The deterrent effect of Criminal Investigation's activities, therefore, have to negate the "audit lottery" perception by the public in order to prevent further slippage.

SENATOR ABDNOR: If tax revenue collections are not tracked, on what basis does CID's management allocate resources among its programs?

MR. EGGER: The Internal Revenue Service is comprised of 7 regions and 63 districts. Criminal Investigation allocates resources only as far as the regional level since the regional managers are in the best position to determine individual district compliance needs and the locations to which resources should be applied for the various programs and emphasis areas. With one exception all special agent staff years are allocated based on our distribution formula. Per the formula, each region's allocation of special agent staff years is computed according to the weighted application of three basic factors: its civilian employment, ages 24 to 64; its individual, partnerships and corporate income tax returns files; and number of revenue agents assigned to the region. The exception is when we receive staffing for a special purpose, such as the Organized Crime Drug Enforcement Task Force Program. In these cases, the designated staff years would be allocated to the regions prior to applying the formula. Other support staffing and operating funds are generally distributed based on special agent staffing.

As implied by this question, revenue collections from criminal investigations are presently not tracked for a variety of reasons, but the answer to the previous question contains a detailed explanation of the present procedure.

SENATOR ABDNOR: CID also contributes to the total federal effort to combat criminal activities. Can CID cite the amount of non-tax revenues generated as a result of its contribution to these federal law enforcement efforts?

MR. EGGER: CID does not track the amount of non-tax revenue that is generated since forfeitures of assets, for the most part are administered by other agencies. CID provides substantial assistance in Organized Crime Drug Enforcement Task Force (OCDETF) investigations including those which involve the seizure and forfeiture of drug related assets. CID's role is significant because of the unique ability of special agents to follow complicated financial trails of hidden asset ownership.

However, as reported in the National Drug Enforcement Policy Board, Federal Drug Enforcement Progress Report of March 1986, through the cooperative efforts of the OCDETFs during the three years of their existence (1983, 1984 and 1985), $322,177,274 in currency and property ($125,788,989 currency and $196,388,285 property) were seized. At the same time, $108,301,683 in currency and property ($32,094,037 currency and $76,207,646 property) were forfeited.

IRS participated in 785 or 67.6% of all OCDETF cases initiated in that three year period. The forfeitures and seizures would not have been possible without a substantial financial link between the assets and the individual narcotics traffickers from whom they were seized or forfeited.

USE OF JEOPARDY AND TERMINATION ASSESSMENTS

SENATOR ABDNOR: Each year, IRS makes a large number of jeopardy assessments and termination assessments. However, we understand that the collection rate on these assessments may be very low because U.S. Attorneys prefer to use non-tax criminal charges to seize funds in question instead of merely taxing them.

Can you describe how and why jeopardy and termination assessments are made?

MR. EGGER: IRS uses jeopardy and termination tax assessments (civil actions that result in the immediate demand for payment of taxes) when there is an indication that collection of a tax may be in jeopardy.

In determining whether a jeopardy or termination assessment may be made, at least one of the following four conditions must exist: (1) the taxpayer is or appears to be designing quickly to depart from the United States or to conceal himself/herself; (2) the taxpayer is, or appears to be, designing quickly to place property beyond the reach of the Government by removing it from the United States, concealing it, dissipating it, or transferring it to other persons; (3) the taxpayer's financial solvency is or appears to be imperiled; or (4) the taxpayer has in his/her possession and denies the ownership of more than $10,000 in cash or its equivalent and refuses to identify the owner of such cash.

Jeopardy assessments are made when collection of any tax is in jeopardy after the due date for filing a tax return has passed. Termination assessments are made when the IRS finds that the collection of income tax is in jeopardy before the end of the tax year.

These assessments are useful in cases of illegal income, since assessments need not only apply to property used in illegal activities, but to all property owned by the individual, regardless of the source of the funds used to acquire the property.

The 1983 U.S. Supreme Court ruling in the Baggott case held that an IRS civil examination was not preliminary to or in connection with a judicial proceeding and therefore Rule 6(e) orders under the Federal Rules of Criminal Procedure can not be issued for such purposes. Since jeopardy and termination assessments are civil proceedings, information obtained in a grand jury investigation may not be used for civil tax purposes if it constitutes a matter occurring before the grand jury.

Prosecutors quite correctly take the position that assets should not be used to satisfy a jeopardy or termination tax assessment if such property is already forfeitable to the Government. The Government would be in effect satisfying the individual's tax lien with assets that already belong to the Government. By making the criminal forfeiture first, the taxpayer has to use other than the illegal source of income to satisfy his/her tax lien. However, where the forfeiture for some reason is legally insufficient, the tax lien can be used to attach the assets.

SENATOR ABDNOR: About how much tax revenue is assessed through jeopardy and termination assessments in a typical year. What percent of this is normally collected?

MR. EGGER: IRS maintains statistics on jeopardy and terminations as a total for each fiscal year. The only category designated separately is in the area of narcotics and narcotics related cases. The amount assessed for narcotics and narcotics related cases for the last three years is as follows:

Fiscal Year	Number of Cases	Assessments (millions)	Average Assessment
1983	260	$ 68.8	$ 264,615
1984	297	116.6	392,592
1985	296	244.0	824,324

IRS does not segregate collection statistics by program, therefore the amount collected is not readily available. It is also difficult to track how much is collected under the current procedures since assessments may remain open for several years while the criminal case is being processed. The assessments are necessary, however, because if the taxpayer obtains a favorable ruling on a forfeiture hearing the IRS can attach the assets to satisfy his/her tax lien. Further, if the taxpayer comes into other income or assets in the future, the outstanding tax liens would still apply.

REFERRING CLOSED CRIMINAL CASES FOR CIVIL ACTION

SENATOR ABDNOR: Many CID cases have both a criminal and a civil aspect. Once the criminal aspect has been disposed of, the case should be referred to another IRS component for possible civil action.

Are all closed criminal cases referred to another IRS component for civil action? What is the referral procedure for discontinued, non-prosecution, and prosecution cases?

MR. EGGER: All CID cases with a civil aspect are referred to the appropriate IRS civil function, Examination, EP/EO, or Collection, upon completion of the criminal features of the investigation. Criminal Investigation is responsible in all completed and substantially completed investigations (prosecution and non-prosecution) to recommend, if appropriate and support, if recommended, the ad valorem additions to the tax except those relating to tax estimations. In prosecution cases, the special agent's report and exhibits are transmitted to the appropriate civil function upon adjudication of the case or when a decision is made at one of the review levels (e.g., IRS Counsel, Department of Justice) not to prosecute. In Non-Prosecution and Discontinued investigations, a copy of the special agent's closing report and relevant documentation is transmitted to the appropriate civil function. The taxpayer is advised by letter that CID is no longer participating in the investigation and the case has been referred to Examination, EP/EO, or Collection for completion.

SENATOR ABDNOR: Have other IRS components pursued civil action on these closed criminal cases? Can CID cite the amount of additional federal tax revenue resulting from civil action on closed criminal cases?

MR. EGGER: The appropriate IRS component will pursue civil action on closed criminal cases. CID does not have a system through which we can determine the exact amount of federal tax revenue collected as a result of Criminal Investigation operations, to include civil action on closed criminal cases. As discussed in the response to question specifically relating to collections from CID activities, CID maintains only limited statistical data in some major program areas that gives us approximate tax revenue collected figures and/or dollar savings to the government. These figures are outlined in that response.

SENATOR ABDNOR: We understand that the Baggot and Sells Supreme Court decisions have precluded the use of grand jury information in civil proceedings. What effect has this had or will it have on CID referrals?

MR. EGGER: The IRS contributes significant resources to assist attorneys for the government in grand jury investigations. In order to protect the revenue in these cases, IRS must document the civil aspects before grand jury referral or duplicate the efforts and resources which have already been invested in grand jury investigations. This latter approach is possible only where the Service can develop independent leads to the same information developed by the grand jury.

The inability to obtain access to grand jury information that has not become a matter of public record prevents the civil functions of the Service from even knowing of existing tax liabilities that have not been assessed. Although the Department of Justice uses its best efforts to ensure that the Service receives all information relevant to a civil liability that may be disclosed under the law, there is no question that revenues are lost because of the present law. The irony of this situation is that most of the individuals profiting from this state of affairs are engaged in illegal activities and are not being held accountable for the taxes they should be paying.

The Service filed a statement with the Senate Judiciary Committee in support of S-1676, which would modify Rule 6(e) of the Federal Rules of Criminal Procedure to permit disclosure of information involving matters occurring before the grand jury for such things as civil tax audits under limited circumstances.

LEGAL REVIEW OF CID CASES

SENATOR ABDNOR: GAO, in a report entitled Streamlining Legal Review of Criminal Tax Cases Would Strengthen Enforcement of Federal Tax Laws (GAO/GGD-81-25, April 29, 1981), stated that the legal review process for criminal tax cases was time-consuming and duplicative. GAO recommended that IRS and the Justice Department jointly develop a streamlined legal review process. The Senate Appropriations Committee made the same suggestion in the report accompanying IRS' 1983 appropriation bill. In 1983, the Grace Commission reiterated GAO's 1981 report findings.

Another GAO report entitled Tax Administration: Information on IRS' Criminal Investigation Division (GAO/GGD-86-23FS, November 8, 1985) indicated that IRS and Justice legal review procedures have been revised to allow for a two category process, and that the timeliness of legal reviews appears to have improved since the 1981 GAO report was issued. However, CID agents still believe the legal review process, as a whole, is somewhat time consuming and redundant.

> Specifically, what has been done to streamline the legal review process? Could further improvements be made within the current legal review framework? What other suggestions could be made for further improving the timeliness of legal reviews?

MR. EGGER: From the Service's standpoint as the referring client for proposed criminal tax prosecutions, recent efforts to streamline the legal review process include:

(1) Concentrating criminal work in fewer attorneys at District Counsel offices to keep expertise at hand;

(2) Continuing and extending training and current guidance for such cadre of criminal tax specialists;

(3) Increasing assistance to CID managers and agents during the investigative stages of cases;

(4) Expanding "noncomplex" case procedures so that cases involving simpler legal or policy problems can be handled more summarily;

(5) Developing a "plea agreement" program so that certain situations in which an investigative subject indicates that he is ready to plead guilty to criminal charges and cooperates towards such end can be handled more summarily;

(6) Eliminating National Office review of most search warrant applications;

(7) Standardizing to a greater extent the formats for legal review documents; and

(8) Stressing as significant management goals the necessity of eliminating "overage" cases.

Questions regarding parallel efforts with respect to the legals reviews at the Tax Division and the United States Attorney offices should be addressed to the Department of Justice.

One possible further improvement within the current legal review framework is now under experimentation in our Phoenix District. District Director investigative personnel will be working virtually in tandem with District Counsel personnel throughout certain promising investigations. The design is that the eventual investigative report will represent an essentially mutual product. Negligible subsequent legal review time or effort will be needed beyond sending a brief transmittal to the prosecutive authority as the referral vehicle pursuant to Secretary of the Treasury delegations. It is too early to tell if the Phoenix pilot idea or some modification thereof should be implemented elsewhere.

As for other suggestions to improve timeliness, the Service remains open-minded. It must be remembered that haste is not the solitary consideration in seeking criminal convictions. If it were, much of time now taken for District Counsel review (today pruned to less than 90 days) could be saved just by cutting out conference opportunities generally afforded to proposed defendants. On balance, the Service continues to believe that the relatively small amount of time so spent is well worthwhile in the interest of sound and effective tax administration.

SENATOR ABDNOR: What is the rationale for having both IRS and Justice attorneys review CID criminal cases? How would a consolidated legal review procedure effect the outcome of criminal cases?

MR. EGGER: Again, from the standpoint of the Service, District Counsel review uniquely achieves uniform application of criminal tax laws while insuring that individual prosecutions further the overall compliance goals of the Service. The Office of Chief Counsel works closely with the Department of Justice and IRS Criminal Investigation in developing prosecution standards and guidelines which are disseminated to the District Counsel offices in the form of directives and manuals. Chief Counsel also conducts a criminal tax attorney training program that emphasizes existing prosecution standards. The seven Deputies Regional Counsel (CT) provide guidance on criminal tax matters in the regions and help insure that uniform standards are being applied.

The review by District Counsel is the only legal review conducted by attorneys who are knowledgeable of and directly involved in developing the overall IRS civil and criminal compliance goals. In addition, prosecution recommendations are not reviewed by District Directors or Regional Commissioners. Consequently, the District Counsel review is the only Service review that a recommendation receives outside of the investigating function.

District Counsel review provides a final opportunity to administratively correct legal problems before referral to the prosecuting authority. Under existing law, the Service is precluded from issuing administrative summonses to obtain information for a criminal prosecution after a referral has been made to the Department of Justice. Problems noted by District Counsel review may be corrected by the subsequent issuance of administrative summonses. Defects noted by the Department of Justice or U.S. Attorney, however, may be correctable only by use of a grand jury. Insufficient prosecutorial resources may preclude resort to a grand jury resulting in a loss of all the investigative time. Even if a problem does not require resort to use of an administrative summons, the close physical proximity of the reviewing attorney and the investigating agent facilitates communication and ultimate resolution of problems.

District Counsel review uniquely provides taxpayers with a convenient opportunity to confer locally at the administrative level with an attorney responsible for making a judgment on the merits of the recommended prosecution. District Counsel offers an opportunity for a conference in almost all cases referred by Criminal Investigation. Taxpayers (or their representatives) avail themselves of this opportunity in approximately 90 percent of the cases. The District Counsel conference safeguards taxpayer rights by refinement of the issues and establishment of all critical facts. The conference often results in a final resolution of the matter at the administrative level.

SENATOR ABDNOR: According to IRS officials, there is a pilot program underway in several cities in which IRS attorneys are temporarily loaned to the Justice Department for prosecuting tax cases in federal court on behalf of the U.S. Attorney's Office.

Can IRS describe this project in more detail, citing project goals, objectives, manpower commitments, and results to date?

MR. EGGER: The Chief Counsel of Internal Revenue and the Assistant Attorney General, Tax Division, Dept. of Justice agreed in principle on September 13, 1984, to permit not more than 10 attorneys in District Counsel offices across the country to become special Assistant United States Attorneys to prosecute criminal tax cases in the general enforcement program. The program, called the Criminal Trial Attorney Program (CTAP), is a pilot program and is subject to the express consent of the United States Attorney who has the complete discretion to experiment with this program.

The program is designed to improve the exposure of lawyers in District Counsel offices in the handling of criminal tax cases. The program is not designed to eliminate the backlog of criminal tax cases pending in any United States Attorney's Office.

Excluded from this program are all drug/narcotic, special enforcement program cases, and grand jury investigations.

To date, 8 lawyers in District Counsel's office have received special designations from the Department of Justice to participate in this program. The program has involved 66 cases nationwide. Of these 66, 9 were disposed of by conviction, 2 were disposed of by pleas of nolo contendere, and 18 were disposed of by guilty pleas. Of the 37 not disposed of, one involves a fugitive from justice and one is on appeal on a collateral matter.

SENATOR ABDNOR: Does this program provide for a more efficient and effective use of the federal government's legal resources than the current system?

MR EGGER: The Criminal Trial Attorney Program (CTAP) provides a more efficient use of the federal government's resources in three ways. First, by using District Counsel attorneys as specially designated Assistant United States Attorneys in criminal tax cases, the United States Attorney's staff is available to try non-tax criminal cases in the district. Second, by participating in criminal tax trials, lawyers in the District Counsel's office enhance their expertise to render timely pertinent legal advice to assist Internal Revenue Service special agents in the investigation of other criminal tax matters. Third, where the District Counsel lawyer who reviewed the case for referral to the Tax Division is the same lawyer who is designated to handle the trial for the United States Attorney, his legal review as trial lawyer should be relatively streamlined.

MONEY LAUNDERING LEGISLATION

SENATOR ABDNOR: The Currency and Foreign Transactions Reporting Act (Bank Secrecy Act) is a major tool in IRS money laundering investigations. However, as we understand it, only a financial institution can violate this act by not filing a currency transaction report (CTR) when required. Thus, the money launderer who successfully or unsuccessfully structures his/her transactions to avoid the filing of a CTR does not violate this Act.

Several bills such as H.2785, H.2786, and S.1335, have recently been introduced in Congress to address the money laundering problem. While these bills would make money laundering a specific crime under Title 18, each bill contains certain provisions which would address the money laundering problem somewhat differently.

What are IRS' views on these and other pending bills? What impact would they have on the person whose criminal proceeds are being laundered? What impact would they have on the persons who are paid to launder the funds?

MR. EGGER: You are correct in your understanding that only financial institutions can violate the Title 31 statutes because the CTR filing duty is imposed only upon the financial institution. However, we have in some judicial circuits, successfully prosecuted money launderers for indirect violations of Title 31 by using Title 18. In such cases, defendants are charged with violations of 18 U.S.C. Sec. 2 (aiding and abetting or causing another to commit an offense) and Sec. 1001 (concealing from the government a material fact by a trick, scheme, or device). For example, in United States v. Tobon-Builes, 706 F.2d 1092 (11th Cir. 1983), the Eleventh Circuit Court of Appeals upheld a conviction under 18 U.S.C. Sec. 1001 where the defendants had engaged in a money laundering scheme in which they had structured a series of currency transactions, each one less than $10,000 but totaling more than $10,000, to evade the reporting requirements.

In contrast, the First Circuit Court of Appeals, in United States v. Anzalone, 766 F.2d 676 (1st Cir. 1985), the Eleventh Circuit Court of Appeals in United States v. Denemark, 779 F. 2d 1559 (11th Cir. 1986), and the Ninth Circuit Court of Appeals in United States v. Varbel, 780 F.2d 758 (9th Cir., 1986) have held that structuring currency transactions to avoid the reporting requirements did not violate 18 U.S.C. Sec. 1001. These decisions have caused us serious problems in enforcing the Bank Secrecy Act. We have in at least one case successfully prosecuted a money launderer for a direct violation of Title 31 by characterizing the individual as a currency dealer. A person in the business of dealing in currency is a Title 31 financial institution subject to the CTR filing requirements. See United States v. Ronderos, et.al., 781 F.2d 1432 (9th Cir., 1986).

We strongly support this legislation and urge favorable action by the Congress. These bills would make the act of money laundering a crime. The bills would prohibit activities that are currently not subject to any statute or regulatory requirement. Since the Department of Justice and the Department of Treasury would share joint jurisdiction, these additional statutes would provide alternative methods of prosecution and create a wider range of available evidence.

SENATOR ABDNOR: Do these bills provide CID with the means to obtain evidence that monetary instruments are being laundered? Would the federal government's burden of proof be excessive?

MR. EGGER: The bills such as H.2785, H.2786, S.1335 and S.1385 would make the act of money laundering a crime. The bills would prohibit activities that are currently not subject to any statute or regulatory requirements. The scope of IRS jurisdiction to investigate money laundering would be broadened, but the means available to obtain evidence would remain the same.

The above statutes require a predicate offense, or evidence of criminal activity in addition to money laundering. Such a requirement makes the government's burden of proof more difficult, but not necessarily excessive. Under Treasury's proposed legislation, proof of another crime would not be necessary in order to convict an individual for violating the Bank Secrecy Act. The provisions of H.2785, H.2786, S.1335 and S.1385, along with Treasury's proposed legislation would give the federal law enforcement agencies the needed tools to combat money laundering.

SENATOR ABDNOR: How would CID propose to alter any of these pending bills to provide IRS with the authority needed to effectively address the money laundering problems?

MR. EGGER: Each bill provides that the Secretary of Treasury or his delegate will have summons authority for Title 31 offenses. However, S.1335, H.R.2785 and H.R.2786 limit the use of a summons to civil purposes. We recommend the summons authority include criminal investigations, similar to the summons authority in Title 26. With respect to S.1385, we recommend that tax evasion, and all Title 26 felonies be clearly included as a predicate offense in any proposed legislation requiring evidence of other criminal activity.

In addition, we urge favorable action on Treasury's legislative proposal discussed in response to the question below. This proposal can be considered an amendment to the Money Laundering and Related Crimes Act or can stand alone.

SENATOR ABDNOR: A recent GAO report, entitled Tax administration: Information on IRS' Criminal Investigation Division, (GAO/GGD-86-23FS, November 8, 1985), indicated that the Assistant Commissioner (Criminal Investigation) believes the Bank Secrecy Act should be amended to combat two common practices in money laundering that are not now illegal. First, he believes it should be illegal for an individual to circumvent the CTR filing requirement by making monetary transactions of less than $10,000 in several financial institutions in one day. Second, he believes it should be illegal for an individual to attempt, but not necessarily succeed, to circumvent the CTR filing requirement by conspiring with officials of a financial institution or by making monetary transactions of less than $10,000 at numerous branches of the same financial institution in one day.

Is IRS considering recommending changes to the Bank Secrecy Act along these lines? Is draft legislation being prepared?

MR. EGGER: These concerns and others are embodied in a proposal for new legislation sent, on January 24, 1986 to Chairman Pickle of the House Ways and Means Oversight Subcommittee. The proposed additions to the Bank Secrecy Act and Title 26 were developed by the Department of Treasury in conjunction with the Internal Revenue Service and have the concurrence of the Department of Justice. The bill contains a critically needed provision to prohibit money launderers from structuring currency transactions to avoid the $10,000 currency transaction reporting requirement and adds an attempt provision. The bill also provides IRS with seizure and forfeiture authority for currency related to a domestic reporting violation or any interest in property traceable to the currency. The forfeiture would not affect bona fide purchasers who took the currency or property without notice of a reporting violation.

In addition to the legislative proposals, Treasury, with IRS and Justice concurrence, is proposing several changes in the Title 31 Regulations aimed at money launderers who break up currency into increments of $10,000 or less in order to prevent a

CTR from beng filed. These changes will increase the duties of both the financial institutions and the customer regarding multiple transactions.

SENATOR ABDNOR: How would these changes differ from those proposed in the bills that have already been introduced in Congress?

MR. EGGER: The Money Laundering and Related Crimes Act embodied in S.1335, S.1385, H.R. 2785 and H.R. 2786 would make the act of money laundering a crime. However, these proposed statutes require a predicate offense, or evidence of criminal activity in addition to money laundering. Therefore these bills, to the extent that they require evidence of other criminal activity, are much narrower in scope than the Bank Secrecy Act which requires reports of all currency transactions over $10,000, whether or not a criminal activity is involved.

The Treasury proposals which are supported by the Department of Justice merely seek to close the existing loopholes in the Bank Secrecy Act which have come about by recent decisions in three Federal Circuits. Under the Bank Secrecy Act, we will be able to convict money launderers without having to prove another criminal activity.

We urge favorable action on the Money Laundering and Related Crimes Act as well as Treasury's requested legislative proposals, since all of these bills complement one another and their passage would provide law enforcement with the necessary tools to combat money laundering and narcotics trafficking.

FEDERAL EXCISE TAXES

CRUDE OIL WINDFALL PROFIT TAX

WINDFALL PROFIT TAX DEFINITIONS

SENATOR ABDNOR: For windfall profit tax purposes, "newly discovered oil" is subject to a much lower tax rate than is "old oil" and is defined as oil produced from a property having no commercial production in 1978. In its mark-up of the Technical Corrections Bill of 1985, the House Ways and Means Committee approved an amendment to the definition of newly discovered oil. The amendment provides that as long as not more than 2,200 barrels were produced from the property in 1978 and production was for not more than 3 days during that year, commercial production is not considered to have begun in 1978.

What kind of compliance concerns, if any, will this amended definition present IRS?

MR. EGGER: It will be difficult to accurately determine the number of days during which oil might have been actually produced in 1978--3 days or 20 days.

SENATOR ABDNOR: In IRS' opinion, based upon experience in examining oil property operators, is 2,200 barrels too liberal an allowance? If so, please explain.

MR. EGGER: Yes, 2,200 barrels is more than a test. Many wells do not produce 2,200 barrels in a year and are, nevertheless, continued in profitable commercial operation for many years.

WINDFALL PROFIT TAX EXEMPTIONS

SENATOR ABDNOR: IRS has issued final regulations setting forth requirements for qualifying for certain exemptions from the windfall profit tax. This regulatory guidance covers oil interests owned by qualified governmental and charitable entities, as well as exempt Indian oil and exempt royalty oil. However, one of the most significant areas--exempt stripper well oil--has not been addressed by final regulations.

What compliance concerns are presented by the absence of final regulations for exempt stripper well oil?

MR. EGGER: We cannot define stripper oil without regulations.

Separate and newly discovered reservoirs present a potential problem--production may significantly exceed 10 barrels per day from the property.

Proposed regulations define an oil well as a well with a gas/oil ratio of less than 50,000 cubic feet of gas to one barrel of oil. On the other hand, the Department of Energy regulations rely upon different criteria; such as a phase test, where gas and oil are separate in a reservoir, gravity test, and a bubble test. Without final regulations, we would not know how to document unagreed cases for trial.

Additionally, we would not know whether to define properties as stripper or as newly discovered, if they meet both tests.

Another significant compliance problem is caused by the Department of Energy regulations which state that a stripper well will be considered a stripper well forever, once so defined. Because of this, oil production may be held back during the qualifying period to qualify as stripper, and then the property is allowed to produce large volumes. If qualification were required each year, it would alleviate this problem.

SENATOR ABDNOR: IRS has issued final regulations setting forth requirements for qualifying for certain exemptions from the windfall profit tax. This regulatory guidance covers oil interests owned by qualified governmental and charitable entities, as well as exempt Indian oil and exempt royalty oil. However, one of the most significant areas--exempt stripper well oil--has not been addressed by final regulations.

When will final regulations be issued?

MR. EGGER: Consideration is still being given to the public comment received in response to the proposed regulations. Additional guidance will be published when our review is completed. However, at this time, it is not possible to predict when this review will be completed.

TERTIARY RECOVERY PROJECTS

SENATOR ABDNOR: For windfall profit tax purposes, incremental oil produced from a qualified tertiary recovery project is subject to a much lower tax rate than is "old oil". To qualify, the project generally must be certified by the U.S. Department of Energy or a state agency. In certain circumstances, it can be self-certified.

Does IRS have sufficient engineering and examination resources to reasonably assure that tertiary recovery projects are legitimate and not abusive of the applicable tax law provisions?

MR. EGGER: Yes, we have adequate engineering expertise which is concentrated in the Southwest and Western Regions where most of the tertiary projects are located.

SENATOR ABDNOR: How many tertiary recovery projects have been "certified" to IRS? Of these certifications, how many were approved by a state agency? Are there any indications that a state's approval may be self-serving? Can, and has, IRS overturned any certifications from state jurisdictional agencies regarding qualification of a tertiary recovery project?

MR. EGGER: We have certified 619 tertiary recovery projects, of which 205 were approved by state agencies. The Service has overturned some state certifications.

SENATOR ABDNOR: What is IRS' audit coverage percentage in this area; i.e., how many tertiary recovery projects have been audited? Has IRS proposed any tax liability adjustments as a result of examinations of such projects?

MR. EGGER: IRS has a 100% selection criteria for referral of tertiary certifications to field offices for review/examination.

Adjustments result primarily from followup review of previously approved projects which were either not implemented or were only partially implemented.

GAS GUZZLER EXCISE TAX

SENATOR ABDNOR: Internal Revenue Code section 4064 imposes an excise tax on non-fuel efficient passenger vehicles manufactured since 1980. Although the tax applies to both domestic and imported vehicles, no domestic vehicles were subject to the tax between 1983 and 1985 because they either achieved the necessary fuel efficiency or were exempt because of their gross weight or use for law enforcement purposes. Accordingly, all revenue received for those years came from imported vehicles.

The imported vehicle market is comprised of (1) factory authorized importers and (2) direct importers. The direct importers market has increased from 1500 imported vehicles in 1980 to about 67,000 in 1985. However, there seems to be some question about the applicability of the gas guzzler tax to direct importers. IRS is in the process of issuing a ruling to clarify who is liable for the tax.

When will IRS' ruling and related procedures be issued?

MR. EGGER: On February 18, 1986, the IRS published in the Internal Revenue Bulletin both a revenue ruling and revenue procedure dealing with the gas guzzler tax. Revenue Ruling 86-20, 1986-7 I.R.B. 16, holds that the gas guzzler tax applies to automobiles imported without a prototype-based fuel economy rating assigned by the Environmental Protection Agency. Most direct importers would fall within the purview of this revenue ruling. Revenue Procedure 86-9, 1986-7 I.R.B. 22, sets forth guidelines for importers to compute gas guzzler tax liability for automobiles that are imported without a fuel economy rating assigned by the EPA.

SENATOR ABDNOR: Internal Revenue Code Section 4064 imposes an excise tax on non-fuel efficient passenger vehicles manufactured since 1980. Although the tax applies to both domestic and imported vehicles, no domestic vehicles were subject to the tax between 1983 and 1985 because they either achieved the necessary fuel efficiency, or were exempt because of their gross weight or use for law enforcement purposes. Accordingly, all

revenue received for those years came from imported vehicles.

The imported vehicle market comprises (1) factory authorized importers and (2) direct importers. The direct importers market has increased from 1500 imported vehicles in 1980 to about 67,000 in 1985. However, there seems to be some questions about the applicability of the gas guzzler tax to direct importers. IRS is in the process of issuing a ruling to clarify who is liable for the tax.

If IRS rules that direct importers are liable for the tax, will the decision likely be prospective or retroactive? If retroactive, how will the Service identify liable taxpayers since 1980? According to IRS officials, compliance efforts to enforce the gas guzzler tax are being curtailed pending issuance of the ruling. Assuming IRS rules that direct importers are liable for the tax, what compliance efforts will be instituted?

MR. EGGER: The decision is retroactive. In a letter dated December 27, 1985, we requested the assistance of the U.S. Department of Transportation (DOT) to identify the importers of "grey market" vehicles. Subsequently, we met with DOT representatives and agreed that an extract of the DOT current and historical Motor Vehicle Import Investigation File be made available to the IRS. We plan to provide a list of the potentially taxable vehicles to the appropriate IRS district offices. Those who appear not to have paid the correct gas guzzler excise tax will be contacted for an appropriate determination.

SENATOR ABDNOR: According to IRS and U.S. Customs officials, some importers may not be complying because they are unaware of the gas guzzler tax.

What procedures are in place to inform importers of their potential tax liability?

MR. EGGER: We have no program specifically designed to inform importers of their potential liability for the gas guzzler excise tax. However, we have coordinated with the Environmental Protection Agency (EPA) to publish a Supplemental Notice of Proposed Rulemaking by revising portions of the EPA regulations at 40 CFR 85.1501 et seq. (Federal Register, September 9, 1985). The portions of these proposed regulations that provide for the continuing importation of nonconforming vehicles, also provide for the EPA to notify certificate holders of the potential gas guzzler excise tax provisions of the Energy Act of 1978, 26 U.S.C. 4064. For vehicles not owned by the certificate holder, IRS Forms 720

(Quarterly Federal Excise Tax Return) and 6197 (Fuel Economy Tax Computation) will be provided. We have been informed that the proposed EPA regulation changes are currently being finalized and could be published as early as late 1986. We will continue to coordinate with the EPA and DOT to ensure the appropriate importers are alerted to the potential for a gas guzzler excise tax liability, and to obtain and use data to ensure the correct excise tax reporting.

SENATOR ABDNOR: Has IRS considered requesting the U.S. Customs Service to issue an advisory notice which would explain the gas guzzler tax as part of its general information packet given to direct importers?

MR. EGGER: No, we have not requested the Customs Service to do this since only a small portion of the total number of importers would potentially be subject to the gas guzzler excise tax. However, as previously mentioned, we have pursued importer notification through coordination with the EPA via revisions to EPA regulations.

SENATOR ABDNOR: IRS assesses the gas guzzler tax based on mileage figures published by the Environmental Protection Agency (EPA). The EPA determines the mileage figures by testing prototypes sold by factory authorized importers. However, many vehicle models imported through the direct importers market are not sold by factory authorized importers; and, therefore, EPA has not issued mileage figures on these vehicles.

Are these vehicles subject to the gas guzzler tax?

MR. EGGER: Yes, in accordance with Revenue Ruling 86-20, IRB 1986-7, dated February 18, 1986.

SENATOR ABDNOR: If so, how are revenue agents made aware that these vehicles are subject to the tax?

MR. EGGER: Revenue agents, including excise tax specialists, are appraised of current technical developments through the distribution of various technical publications. In addition, current technical developments are considered for presentation during the annual continuing education training program provided to revenue agents in each district.

SENATOR ABDNOR: Also, since no EPA mileage figures are available, what basis is used for determining the tax?

MR. EGGER: Revenue Procedure 86-9, IRB 1986-7, dated February 18, 1986, provides guidelines for importers of automobiles to compute the gas guzzler liability under Section 4064 of the

Internal Revenue Code for automobiles imported without a fuel economy rating assigned by the EPA. Also provided is a listing of EPA-prescribed fuel economy ratings for model years 1980 through 1986.

WAGERING TAXES

SENATOR ABDNOR: IRC Sec. 4401 imposes an excise tax on certain types of wagers. The taxes due are based on a percentage of taxable wagers received--0.25 percent for state authorized gambling activities and 2 percent for unauthorized activities. Monthly returns are required to be filed regardless of the amount of wagering taxes owed. There does not appear to be a continuing need for the monthly filing requirement for the excise tax on wagers. IRS stated in prior testimony that it would be more cost effective to require quarterly filing and further stated that the Service would look into the matter and determine if the filing requirement should be changed.

What is the status of IRS' review of the monthly filing requirement?

MR. EGGER: We believe any savings from this recommendation would be negligible in light of the relatively minimal processing costs now incurred: $1.35 for each Form 730, Tax on Wagering, with a projected tax year 1986 filing universe of only 25,000 returns. Revising the current monthly filing requirement also would likely generate more in overhead costs (programming, changing forms and instructions, alerting taxpayers, etc.) than it would save in processing costs. Our compliance activities are very concerned that such a change would create taxpayer uncertainty, break established filing habits, and effect the Service's ability to identify trends, patterns, and nonfilers. We would, of course, be pleased to review this further if any additional information becomes available to verify cost savings or minimize compliance impact.

INTERNATIONAL TAXATION

FOREIGN INFORMATION RETURNS

SENATOR ABDNOR: Over the past several years, GAO has testified on shortcomings associated with IRS' processing of foreign information returns. These returns are provided to IRS by foreign countries which have entered into tax treaties with the United States. The returns are designed to provide IRS with information on income earned abroad by U.S. taxpayers.

According to GAO, while IRS received an average of 677,000 foreign information returns annually from treaty partners for tax years 1980, 1981, 1982 and 1983, IRS could not process about one-third of the returns. GAO, as well as IRS' Internal Audit Division, has also noted that IRS lacks procedures to measure the compliance level of reported foreign-source income earned by U.S. taxpayers .

Does IRS believe that underreporting of foreign source income by U.S. taxpayers is a problem?

MR. EGGER: We believe that a problem exists, and have established the Foreign Information Return Program to identify and measure the scope of such underreporting. However, our previous document matching procedures did not permit us to segregate audit results between (FIRP) and other issues. Beginning January 1, 1986, a checksheet is being attached to all FIRP documents perfected and forwarded by the Service (approximately 15,000 per year). This will provide the data necessary to evaluate both the effectiveness and necessity of this program. To date, we have received 405 checksheets on documents reporting a total of $50,402,321. All income shown on these documents was reported by the taxpayers. Form 8478 will continue to be used for one year, after which we will evaluate the results.

SENATOR ABDNOR: What can IRS do to improve compliance in this area?

MR. EGGER: In addition to improving internal procedures and developing a checksheet for use during audits, we are working with our tax treaty partners to develop information returns that will assist us in verifying the correct tax liability.

SENATOR ABDNOR: What actions have our tax treaty partners taken to assist IRS in this area?

MR. EGGER: The Service is increasing efforts to improve the quality of information received under the Foreign Information Returns Program. At every available opportunity, we stress to our treaty partners the importance of the quality and timeliness of the information furnished under the routine exchange program. During the past year, as a result of our efforts, some of our treaty partners have sent us new forms for inclusion in the Foreign Information Returns Program (FIRP). We have also advised our foreign counterparts that we have a program in place which attempts to use information documents which do not meet the criteria for our automated system.

FOREIGN EARNED INCOME EXCLUSION

Senator ABDNOR: U.S. taxpayers living in a foreign country are subject to the same U.S. income tax laws that apply to taxpayers living in the United States. In other words, U.S. citizens and residents generally are taxed by the U.S. on their worldwide income with several exceptions.

One of the more significant of these exceptions is the foreign earned income exclusion. This allows U.S. taxpayers living abroad to exclude up to $75,000 of their foreign earned income from their U.S. taxable income. The Joint Committee on Taxation has estimated that the foreign earned income exclusion will reduce federal tax revenues by about $8 billion during the fiscal year period 1986 through 1990.

Have any studies been conducted concerning the efficacy of the exclusion or the reasonableness of the $75,000 limit?

Mr. EGGER: The foreign earned income exclusion was reinstated in the Internal Revenue Code by the Economic Recovery Tax Act of 1981 (ERTA). That act requires a report to Congress concerning the effects of the exclusion. IRS is now assembling information from 1983 tax returns for a report which Treasury will prepare.

SENATOR ABDNOR: Does IRS have statistics concerning the number and location of taxpayers claiming the credit?

MR. EGGER: Yes, the latest country data available are for Tax Year 1979. There is a study currently underway for Tax Year 1983. Preliminary results will be available in September 1986.

TAX CONSEQUENCES OF FOREIGN INVESTMENT IN U.S. REAL ESTATE

SENATOR ABDNOR: The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) was designed to respond to the perceived problem of excessive foreign investment in U.S. real property at favorable tax rates. Before the enactment of FIRPTA, foreign investors, unlike U.S. taxpayers, could easily avoid U.S. taxes on real property rents and capital gains by structuring transactions through entities established in foreign countries. Under FIRPTA, foreign sellers of U.S. real estate are subject to a 10 percent tax on the gain resulting from the sale. Although FIRPTA was to take effect in 1985, final regulations on the collection of the tax have not been issued.

What is the status of the regulations?

MR. EGGER: The provisions of FIRPTA, passed in 1980, are set forth in I.R.C. section 897. It subjects foreign sellers of U.S. real estate to capital gains tax. Final regulations on the capital gains tax were published in December, 1984. Additional regulations on special rules dealing with corporations and partnerships are currently being developed.

In 1984, I.R.C. section 1445 was passed, imposing a 10 per cent withholding obligation when a U.S. real property interest is acquired from a foreign person. Temporary regulations were published for section 1445 in December, 1984, before the withholding tax took effect. Those temporary regulations are now being amended in response to public comments. We expect the final regulations for section 1445 to be issued within the next 30 days.

SENATOR ABDNOR: The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) was designed to respond to the perceived problem of excessive foreign investment in U.S. real property at favorable tax rates. Before the enactment of FIRPTA, foreign investors, unlike U.S. taxpayers, could easily avoid U.S. taxes on real property rents and capital gains by structuring transactions through entities established in foreign countries. Under FIRPTA, foreign sellers of U.S. real estate is subject to a 10 percent tax on the gain resulting from the sale. Although FIRPTA was to take effect in 1985, final regulations on the collection of the tax have not been issued.

How will IRS monitor and enforce compliance with the law?

MR. EGGER: Forms 8288, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests, and the related Forms 8288-A, Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests, are required to be filed by U.S. persons who purchase real property from foreign persons (individuals, corporations, etc.). The U.S. purchaser is required to withhold 10% of the sales price of the real property, remitting the 10% withheld to the IRS with a Form 8288. The foreign person may apply to the Foreign Operations District (FOD) within IRS to have the 10% withholding reduced or eliminated (either prior to or subsequent to the withholding).

The Service will be generating a series of reports on the Forms 8288 and Forms 8288-A filed. Two sets of reports will be provided for each of the forms, one report alphabetically and one report numerically by Taxpayer Identification Number (TIN). In addition, reports of filed Forms 8288 (withholding agent) will be generated to each IRS region based on the address of the withholding agents and covering all states within the regions. A separate report of Forms 8288-A, by country, will be used to comply with the exchange of information provisions for our treaty partners. These will be used to correlate examinations of U.S. taxpayers who purchase real property interests from foreign persons, for possible noncompliance with FIRPTA.

SENATOR ABDNOR: How much estimated revenue is the Act expected to generate?

MR. EGGER: The Joint Tax Committee estimates that the revenue from FIRPTA will generate cumulative revenues of $200 million from 1980 through 1985. In FY 1986, the first full year of implementation, estimated revenues will be $200 million. After 1986, the Committee estimates a 10% increase each year until FY 1991 ($210 million in 1987, $221 million in 1998, and so forth). Thus, cumulative revenue from 1980 through 1991 is over $1.5 billion.

REORGANIZATION OF IRS' INTERNATIONAL OPERATIONS

SENATOR ABDNOR: IRS is currently reorganizing the management structure for its international tax administration activities to improve their effectiveness. The changes were suggested as part of a study completed by Bocz, Allen and Hamilton in October 1985. Among other things, the study recommended that IRS should consolidate international program management responsibilities in one organization.

What is the status of the reorganization? When does IRS expect to complete it?

MR. EGGER: The reorganization which will consolidate international tax administration activities under an Assistant Commissioner is currently in process. The reorganization was approved by the Department of the Treasury on February 27, 1986. The current Assistant Commissioner (Examination) has been appointed to the position of Assistant Commissioner (International). We plan to have the new organization in place and functioning by June 30, 1986.

SENATOR ABDNOR: How will the reorganization address the tax return and foreign information return processing problems which IRS has experienced?

MR. EGGER: One of the major immediate tasks of the Assistant Commissioner (International) will be to conduct a study of foreign return filing procedures. The study will address all aspects of foreign returns, including both tax returns and the various information returns covering foreign transactions. It will cover filing procedures, processing problems and taxpayer compliance with current filing requirements.

SENATOR ABDNOR: Will the processing of all tax returns filed by foreigners and United States taxpayers living abroad be consolidated at one service center?

MR. EGGER: All returns filed by nonresident aliens and those filed by United States taxpayers living abroad are currently filed at the Philadelphia Service Center. After the reorganization we will study filing procedures and determine if the current system and filing location are the most efficient and effective.

TAXATION OF LEGAL ALIENS

Senator ABDNOR: The Congress and IRS are concerned about the failure of foreigners, both resident and nonresident, who have received visas to enter and/or work in the United States, to file federal income tax returns and pay taxes on their income. Resident aliens are taxed on all of their income, including that earned outside the United States, while nonresident aliens are subject to tax only on their U.S.-source income. Although no estimates exist concerning the magnitude or extent of the problem, IRS recognizes that tax compliance by foreigners is a problem. In fact, IRS' Internal Revenue Manual states:

> "Every year a number of nonresident aliens come to the United States for temporary employment. Through subterfuge or ignorance of their tax responsibilities, many of these aliens return to their home country without paying taxes on the income earned in the United States."

Has IRS made any attempt to determine the magnitude of the nonresident alien underreporting or nonfiling problem especially the extent of revenue losses?

Mr. EGGER: IRS has not estimated the magnitude of the revenue losses associated with nonresident alien underreporting or nonfiling.

SENATOR ABDNOR: How does IRS coordinate with the Immigration and Naturalization Service, the Department of State, and the Social Security Administration concerning aliens in the United States? How effective is that coordination?

MR. EGGER: The I.R.S. currently has little contact with the State Department concerning the taxation of aliens. However, the Social Security Administration provides us with the names of all persons that have received income and this information is used in the document matching program.

The Immigration and Naturalization Service provides us with a form for self-employed individuals to see that adequate tax is being withheld. In the wage earner category, payers of income for legal aliens are required to withhold 30% at source. The aliens are required to file Form 1042.

SENATOR ABDNOR: How does IRS use federal government statistics and data on aliens in the United States in its effort to monitor income tax compliance?

MR. EGGER: Currently we do not monitor compliance of aliens separately.

TAXATION OF ILLEGAL ALIENS

Senator ABDNOR: Approximately six million illegal aliens currently reside in the United States. While these illegal aliens strain federal, state, and local governments' educational, medical, and legal systems, they may also be earning income which is not being taxed by the federal government. Congressional concern over the illegal alien problem is evident by the numerous hearings that have been held in an attempt to reform the Nation's immigration policies.

What has IRS done to identify the amount of revenue being lost from illegal alien's nonfiling of federal income tax returns? Are any efforts being made to collect this revenue?

Mr. EGGER: We estimate that about $100 million of tax on incomes earned in the legal sector was lost annually from 1973 to 1981 due to the nonfiling of individual Federal income tax returns by illegal aliens. Most legal source illegal alien income is wages, on which income tax is withheld.

Under the Apprehended Illegal Alien Program, IRS has a procedure that may be used to collect income tax from illegal aliens who have been apprehended by the Immigration and Naturalization Service.

SENATOR ABDNOR: How does IRS coordinate with other federal agencies concerning illegal aliens in the United States?

MR. EGGER: Currently, IRS does not coordinate with other agencies as to illegal aliens.

TAXATION OF U.S. CITIZENS LIVING IN FOREIGN COUNTRIES

SENATOR ABDNOR: On May 8, 1985, GAO testified before the House Government Operations Subcommittee on Commerce, Consumer, and Monetary Affairs, on U.S. citizens living in foreign countries and not filing federal income tax returns. GAO reported that an estimated 61 percent of its ample of U.S. citizens residing overseas had no record with the IRS of filing an income tax return. According to GAO, a contributing factor to this nonfiling problem is the limited tax information available to the IRS for use in improving compliance among U.S. taxpayers residing overseas. GAO suggested that (1) IRS and the Department of State explore potential avenues for collecting information that leads to improved tax compliance and (2) the exchange of tax information between the IRS and foreign governments be improved.

What actions have been taken and what results can be reported concerning IRS and Department of State efforts to explore new avenues of information exchange to improve tax collections and compliance?

MR. EGGER: Cooperative efforts with the Department of State are constrained by Privacy Act provisions and lack of statutory authority for them to obtain certain information which might be useful to us. Among our legislative proposals was one which would have required passport applicants overseas to furnish their social security numbers and other current tax information. Also, in that same legislative proposal was a provision to require the Department of State to provide the Internal Revenue Service information concerning U.S. citizens dying overseas. Such information would be useful in identifying nonfilers of estate tax returns. However, these proposals did not find their way into the House Tax Reform Bill (H.R. 3838).

A number of other avenues of cooperation, not requiring legislative changes, have been identified and pursued in an effort to promote overseas tax compliance. I will describe some of these.

In cooperation with the State Department's Office of Consular Affairs, the IRS is arranging for copies of IRS Publication 593, Income Tax Benefits for U.S. Citizens Who go Overseas, to be stocked and displayed in all 13 passport offices in the U.S. This publication highlights the filing requirements for U.S. citizens residing overseas, and provides specific information as to when and where to file returns.

In connection with the IRS Stopfiler and Nonfiler Programs, we have developed an information notice which has been sent to taxpayers with foreign addresses. I would like to submit that notice for the record.

U.S. Citizen and Resident Aliens Abroad

> If you are a citizen or resident alien living or traveling abroad, you are liable for tax on your worldwide income. The income tax filing requirements are the same as if you were residing in the United States. You are required to file an income tax return to elect the benefit of the foreign earned income exclusion, foreign tax credit, or foreign housing exclusion. If you do not elect these benefits timely, it may result in their loss. Pension and annuity income, and interest, dividend, and other kinds of investment income do not qualify for the foreign earned income exclusion. For more information, please get Internal Revenue Service Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad, which is available at U.S. Embassies and Consulates worldwide.

A "Filing Facts" tax package stuffer was included in the tax packages sent to taxpayers with foreign addresses. Stuffer information included a brief summary of significant law changes, filing tips and the availability of tax forms and taxpayer assistance.

The same media received the Service's annual filing period news release which expanded on the information contained in the same tax package stuffer.

For the first time, information was issued to appropriate overseas media publicizing the Service's annual overseas tax assistance tours.

SENATOR ABDNOR: What actions have been taken and what results can be reported concerning expanding the exchange of information with foreign countries and improving the quality and timeliness of the information which is exchanged?

MR: EGGER: The Service is increasing efforts to improve the quality of information received under the Foreign Information Returns Program. At every available opportunity, we stress to our treaty partners the importance of the quality and timeliness of the information furnished under the routine exchange program. During the past year, as a result of our efforts, some of our treaty partners have sent us new forms for inclusion in the Foreign Information Returns Program (FIRP). We have also advised our foreign counterparts that we have a program in place which attempts to use information documents which do not meet the criteria for our automated system.

The Service is presently conducting a survey of the largest banks operating within four treaty countries to determine if the U.S. is receiving information with respect to interest on deposits held by U.S. citizens and residents with major foreign banks. When the results of our test are compiled and analyzed, we will determine the appropriate course of action.

The majority of the information received under the routine exchange program is supplied by Canada, generally on Form NR4. This form is filed by Canadian payers reporting payments of Canadian sourced income to nonresident aliens. The Canadian payers file paper documents with Revenue Canada and they routinely send the documents concerning U.S. persons to us. The Philadelphia Service Center receives thousands of Canadian paper documents each year.

In an attempt to ease some of the administrative burden of the Service, we are currently pursuing the possibility of having Canadian payers file NR4 information on U.S. compatible magnetic media. While this project is not complete, some of the large Canadian payers have indicated a willingness to file this information on magnetic media. In this effort proves feasible, then the program will be more efficient.

One of our treaty partners has agreed to a time schedule for sending documents to us. Another has revised their internal procedures for collecting information so they are able to provide quality information to us. We are also working with one of our less developed country treaty partners to obtain routine information and have offered to assist them in creating a document to send to us.

IRS AUDIT QUALITY

SENATOR ABDNOR: In a June 12, 1985 report (GAO/GGD-85-26), GAO pointed out that both GAO and IRS had found problems with the quality of IRS' small corporation audits and that IRS was undertaking a major initiative to enhance the quality of such audits.

What corrective actions does IRS' initiative involve?

MR. EGGER: Several initiatives are underway that are intended to improve the quality of all audits including those regarding small corporations. These initiatives have been developed at all levels of the Examination function, National, Regional, Service Center and District, and are part of a coordinated effort to improve quality.

An "on-line" quality review process is being developed that utilizes the most current private sector approaches to quality - having the first level manager review cases of examiners at the local group level.

We also have the Coordinator Agent Program which allows experienced revenue agents to transfer skills to less experienced agents including auditing expertise, inventory management practices, and good work habits.

The Span of Control Study allows the manager sufficient time to properly develop employees and to become actively involved in casework.

The basic revenue agent training program has been resequenced to provide additional classroom training and significantly more on-the-job training to assure continuity between tax issues covered in class and the returns assigned during that on-the-job training. The extended training cycle will allow more time to absorb technical tax law material and apply that knowledge in an on-the-job setting under the close supervision of a coach and group manager.

A two week course to upgrade the auditing skills of revenue agents has been developed by a Big Eight accounting firm.

Another significant project involves developing a long range training strategy. This includes looking at the job requirements and the environment that examiners will face in the future, and determining the skills needed to perform effectively under these changing conditions.

ENATOR ABDNOR: What progress has been made toward implementing those corrective actions?

R. EGGER: The status of the quality initiatives that I just described are in various stages of implementation.

The "on-line" quality review process and the Coordinator Agent Program will begin Servicewide implementation in FY 1986.

The Span of Control Study has been fully implemented.

All phases of the resequenced revenue agent training program program have been completed except for redesigning the advanced corporate phase of the training. This phase is expected to be completed in FY 1987.

The auditing course has been piloted and will be ready for use in FY 1986.

The final study report for the long range training strategy will be completed early in FY 1987. Implementation plans will be drawn up in FY 1987 with redesign to begin in FY 1988.

SENATOR ABDNOR: What are the estimated costs and benefits of IRS' initiative?

MR. EGGER: This budget request includes $3.6 million for Examination training in the FY 1986 Budget Supplemental and $3.3 million in the FY 1987 Budget. These additional funds will permit the Service to train all incumbent revenue agents and new recruits in the updated auditing techniques. The development of this auditing techniques course by a Big Eight accounting firm will cost the Service an estimated $250,000 in out of pocket expenditures in FY 1986. The benefits are not quantifiable, but a higher quality product will be provided to the taxpayer.

SENATOR ABDNOR: Does IRS have any other quality enhancement initiatives underway with regard to other types of audits?

MR. EGGER: Other efforts to improve the effectiveness of Examination's audit quality includes a fraud awareness course, a course dealing with the rights, powers and responsibilities of examiners, and courses directed at detecting unreported income. Examination managers are now more involved in all training and course development activities to bring management experience and perspective to these efforts.

Initiatives to attract and retain quality personnel have also been developed. We have adjusted our resource planning process to allow us to fill next year's attrition before it occurs and to permit our outside hiring to be brought in line with major college graduation dates during June of each year.

The revenue agent rating schedule has been revised to give added weight to "core" accounting courses such as Intermediate Accounting, Advanced Accounting and Cost Accounting. Also, added weight is given to knowledge of computers, data processing and information systems.

We have redesigned the tax auditor examining system to predict success on the job. The new system consists of a written test that replaces the previously abolished PACE examination, a job preference survey, and a new standardized selection interview. We expect this system to improve the selection process over that offered previously.

Two AICPA tests are being given to new revenue agent recruits. With this information we can correlate test results with the educational background of our new hires, their success in training and their future on-the-job success. This will allow us to better identify recruit training needs, improve our recruiting processes and help us to update our training programs.

We are also working to improve our recruiting processes by improving college relations to attract highly qualified candidates to IRS employment.

IRS AND SOCIAL SECURITY COOPERATION

SENATOR ABDNOR: In May 1985, GAO issued a report entitled IRS and SSA Can Improve the Verification and Recording of Data Provided by Self-Employed Taxpayers ((GAO/GGD-85-21). GAO found that about 220,000 individuals did not receive about $680 million in earnings credit for fiscal year 1979, and the Social Security Administration (SSA) did not receive about $32 million in SSA. GAO said that IRS could help SSA properly credit earnings that Social Security has not been able to resolve and credit to individuals' accounts. To what extent has corrective action been taken on the recommendations in GAO's report?

MR. EGGER: The GAO report contained ten recommendations. IRS has sole responsibility to implement corrective actions on four of the ten. Corrective actions on three of the four were put in effect January 1, 1986. Developmental work on the other item is well underway. This later item involves tax returns filed in prior years and therefore is not required for our current processing.

In addition, IRS has a joint responsibility with SSA for three more of the ten recommendations. Corrective actions have been implemented for two of these three.

SENATOR ABDNOR: Which GAO recommendations have not yet been implemented, and why?

MR. EGGER: GAO recommended that IRS identify and provide SSA self-employment records showing different Social Security Numbers (SSN's) for the same person or self-employment earnings that were not previously provided during 1980 through 1983. Our historic data files do not contain the information necessary to implement the corrective action as recommended by GAO. We are actively working with SSA to develop an alternative method that is compatible with both agencies files.

GAO also recommended that IRS should help SSA identify individuals who did not receive proper credit for their wage earnings. We have agreed to test a method that will match an SSA file to an IRS file. SSA expects to provide us their test file in late April.

SENATOR ABDNOR: Can IRS elaborate on the extent that it expends resources, particularly for the self-employed, to help SSA solve some of the identification problems that prevent individuals from receiving credit in their Social Security accounts?

MR. EGGER: For most self-employed workers, we verify the correctness of Social Security taxes on reported earnings and forward information to SSA that can be used to properly credit the accounts of self-employed individuals. We have taken steps to improve processing of SE schedules. In 1984, we began to use an error register to check for certain types of incorrectly computed earnings, for example, those situations where the sum of farm and nonfarm earnings was greater than the earnings amount shown on the SE schedule; and where an optional method for determining earnings was improperly used. Beginning in January 1986, adjustments to Self-Employment income for certain accounts will be done via tape instead of the current manual preparation and forwarding of forms.

SENATOR ABDNOR: Is IRS planning to increase its resources in this area?

MR. EGGER: We have already increased our resource expenditure in this area by implementing the GAO recommendations plus the other changes that we had made that GAO acknowledged in their report.

SENATOR ABDNOR: Has IRS explored whether some of the individuals that SSA could not properly identify to give them credit for Social Security purposes are the same individuals that IRS has problems identifying for tax reporting purposes?

MR. EGGER: In the context of the problems cited in the GAO report, IRS does not experience the same problems. We can complete the processing of the individual's return and then perfect any problems we have with the individual's SSN at a later time.

SENATOR ABDNOR: Does IRS have similar problems with employers not properly identifying employees and their earnings?

MR. EGGER: Beginning with tax year 1979, employers are no longer required to identify employees and their earnings to IRS. The employer files an Employment Tax Return showing their tax liability with the IRS. Forms W-2 are filed with the SSA which identify employees and their earnings. IRS and SSA later match the totals reported and correspond with the employer if there is a discrepancy. In cases where the employer has not provided W-2's to SSA so the employee's account can be credited, SSA is responsible for resolution.

EXPEDITE REFUND PROGRAM

SENATOR ABDNOR: In 1985, IRS established the Expedite Refund Program under which taxpayers who had not received their refunds within 16 weeks could file a duplicate return that would then receive expedited processing by IRS. As of October 11, 1985, the service centers had received a total of 308,240 duplicate returns.

How many duplicate returns were received at each of the service centers for the entire 1985 filing season?

MR. EGGER: By January 31, 1986, we had received a total of 328,491* duplicate refund returns. Each center received the following volumes:

Andover Service Center	6,852
Atlanta Service Center	33,267
Austin Service Center	38,905
Brookhaven Service Center	20,607
Cincinnati Service Center	5,631
Fresno Service Center	16,622
Kansas City Service Center	11,283
Memphis Service Center	17,889
Ogden Service Center	9,753
Philadelphia Service Center	167,682

*In order to ensure that all affected taxpayers received expedite treatment, service centers included duplicates other than Expedite Refund Program in their inventories.

SENATOR ABDNOR: Did all duplicate returns involve refunds, and were all the refunds paid?

MR. EGGER: In addition to the 328,491 duplicate refund returns that we received, we also received 1,097 duplicate balance due returns. Upon receiving the duplicate returns, the service centers conducted research to determine if the original returns could be located. Based on this research, only 193,560 of the duplicate refund returns had to be processed; the remaining returns were located in the service centers. Of this volume, 651 refunds remain to be issued. We are continuing to expedite the remaining refunds in inventory.

SENATOR ABDNOR: Does IRS expect to establish another program this year for processing duplicate returns?

MR. EGGER: Based on the improvements that have been made to our service center processing system, we do not believe that last year's problems will recur. Consequently, we do not anticipate that the duplicate return program will need to be continued.

SENATOR ABDNOR: Did IRS uncover evidence that taxpayers abused the duplicate return procedure, for example, by trying to avoid interest on a return with a balance due that the taxpayer claimed to have already paid?

MR. EGGER: We did not.

ERRONEOUS NOTICES

SENATOR ABDNOR: In a November 1, 1985 report, IRS' Office of Internal Audit stated that "Certain business tax returns and tax payments were not timely processed which caused erroneous notices. These notices either incorrectly advised taxpayers that they had not filed tax returns when they had already filed or erroneously billed taxpayers when they had already made payments."

The most prominent example involved a Federal Tax Deposit tape that was not processed in a timely manner by the Philadelphia Service Center causing most of the 26,000 business taxpayers whose deposits, totaling about $296.9 million, were recorded on that tape to receive at least one erroneous balance due notice.

Another example of an untimely processed computer tape involved about $3 million in payments from about 5,600 taxpayers. This tape, which was not timely processed by the Kansas City Service Center, caused erroneous collection actions, including the issuance of 114 erroneous levies. Service center collection staff had to call the affected taxpayers and levy sources to determine the status of the levies, apologize for their issuance, and provide instructions on how to handle the levies.

How many erroneous notices were generated in total at IRS' 10 service centers last processing season? How many erroneous notices were intercepted by the IRS before being mailed and how many erroneous notices were actually mailed?

MR. EGGER: There are currently no statistics maintained on the number of erroneous notices intercepted or actually mailed. Whenever a processing problem is identified where notices have been generated, the service centers are notified immediately not to mail the notices. The centers subsequently receive another tape of the corrected notices to be printed and reviewed.

We have taken positive steps to minimize erroneous notices being generated. Currently, we have a proposal to implement an automated Notice Review Processing System with emphasis on providing a better quality first notice to taxpayers. This system is scheduled to be tested in April, 1986, at the Atlanta Service Center.

SENATOR ABDNOR: Describe what steps are taken, if any, to check the accuracy of notices before they are mailed.

MR. EGGER: The current notice program is responsible for verifying the accuracy of notices and refunds issued to taxpayers. This is accomplished by comparing computer output (notices) to tax returns and adjustment documents. Those notices with the highest probability of error are reviewed 100% to ensure accuracy. The remaining notices are sample reviewed based upon a computerized selection process which selects a number of notices in ratio to the total notices generated. However, the centers are required to escalate the number of notices reviewed whenever a systemic problem has been identified.

SENATOR ABDNOR: In view of what happened last processing season, has IRS improved its notice review process? Please describe any improvements and provide any available management information to demonstrate the effectiveness of those improvements.

MR. EGGER: In our effort to improve the quality of notices issued to taxpayers we have taken the following actions:

- In May 1985, we developed a program to match payments delayed in processing with notices so that the notices reflected the most current information in-house.
- In July 1985, the sampling criteria were modified to select those notices with a high potential for error, rather than strictly a random sample as previously done.
- Beginning in January 1986 we combined notices whenever possible to reduce the number of notices being issued to a taxpayer.
- In addition, in January 1986, we began issuing two new notices to help explain to business taxpayers where their Federal Tax Deposits were applied. These notices were designed to address the continual problem of correct application of FICA and Income Tax Withheld by employers.
- As a future enhancement, we are implementing a Notice Review Processing System which will automate the notice review process with emphasis on providing a better quality first notice to the taxpayer. The system will allow for review of all notices where a subsequent action has occurred such as a remittance received. By accessing various input streams for pending transactions, the matching process will identify notices with the highest probability of errors and "flag" them for Notice Review. This system is scheduled to be tested at the Atlanta Service Center in April, 1986.

We are confident that these actions taken will assist the Notice Review process in identifying and correcting potentially erroneous notices. Although we do not have any management reports on the efforts undertaken, we are continuously in contact with the service centers on the effectiveness of these programs.

1985 COMPUTER TAPE PROCESSING PROBLEMS

SENATOR ABDNOR· Can IRS provide an accurate accounting of how many incidents of unprocessed computer tapes actually occurred during 1985 and at which Service Centers they occurred?

MR. EGGER: Yes, during 1985, the Service's Internal Audit function identified and reported eleven instances of unprocessed computer tapes in addition to the instance at the Kansas City Service Center provided by Mr. Finch, of the General Accounting Office, in his statement before the Subcommittee on Oversight on December 16, 1985. The eleven incidents reported by Internal Audit occurred at the Philadelphia (7), Brookhaven (2) and Fresno (2) Service Centers.

SENATOR ABDNOR: Please describe some of the specific controls mentioned during the Fiscal Year 1986 appropriations hearings that were to be installed to avoid the non-processing of computer tapes at the Service Centers.

MR. EGGER: Instructions and forms for run-to-run balancing to ensure the integrity of Service Center processing of tax returns through the mainline programs have been standardized and issued to all Service Centers as Document 7076, Data Integrity and Run-to-Run Balancing. Features of these procedures include: (1) program halts whenever a program detects a discrepancy during its internal balancing process; (2) manual balancing to ensure that all files (tape and disk) are properly processed from one run to the next; (3) a requirement that each run be balanced prior to release of output to any succeeding run; and, (4) specific instructions for documenting and controlling processing discrepancies and run imbalances to ensure proper resolution.

Instructions to prevent loss of control over tapes shipped from the Service Centers to the National Computer Center were issued on April 24, 1985, as a revision to Internal Revenue Manual 2800, Magnetic Media Management. New instructions were added to provide for documentation and monitoring of all requests from the National Computer Center for replacement of missing, damaged or unprocessable tapes.

SENATOR ABDNOR: In its December 16, 1985, testimony before the House Oversight Subcommittee of the Committee on Ways and Means, GAO discussed instances of computer tapes not being properly processed at service centers other than Philadelphia, namely Kansas City, Atlanta, and Cincinnati. Please explain how these incidents happened in view of the fact that strengthened controls over Service Center tape processing had supposedly been installed?

MR. EGGER: The incidents of tapes not being properly processed at the Kansas City, Atlanta and Cincinnati Service Centers occurred prior to or at approximately the same time that the tape processing problem was emerging at Philadelphia. The Kansas City processing error occurred on or about January 15, 1985, and was identified by Internal Audit on March 1,1985. The problems involving tapes from the Atlanta and Cincinnati Service Center occurred in the processing of tax year 1983 Information Returns Program documents during 1984. These problems were identified early in 1985 at the National Computer Center. The strengthened tape processing controls which were published on April 24, 1985, for nationwide implementation.

CORRESPONDENCE AND OTHER INVENTORIES

SENATOR ABDNOR: As of the end of October 1985, IRS' 10 service centers had a total of 1,334,279 cases in their adjustments/correspondence inventories, compared to 968,950 cases at that time in 1984. One of IRS' two criteria for determining a manageable adjustments/correspondence inventory is that no more than 20 percent of the cases in the inventory remain unresolved for more than 45 days. Of the controlled cases in the inventory at the end of October 1985, however, 73 percent were more than 45 days old.

Unpostable inventories also increased. An unpostable condition is one that prevents a transaction that has been processed through the service center from posting to the taxpayer accounts (otherwise known as the master file) at IRS' National Computer Center. As of the end of October 1985, the 10 service centers had a total of 1,911,009 cases in their unpostable inventories, compared to 859,212 at that time in 1984.

How large were the correspondence and unpostable inventories at the end of 1985, and what is the current size of these inventories?

MR. EGGER: At the end of 1985, we had 1,145,113 correspondence cases and 1,576,966 unpostables. As of February 14, 1986, we had 1,108,719 correspondence cases and 1,585,666 unpostables.

SENATOR ABDNOR: What steps, if any, has IRS taken to be more responsive to taxpayer' inquiries?

MR. EGGER: IRS took the following steps to be more responsive to taxpayers' inquiries:

- Required that all correspondence be answered even if the action taken was exactly what the taxpayer requested. This procedure ensures that the taxpayer receives a written response, instead of a notice, explaining what was done to his/her account.

- Required an acknowledgement to all correspondence that can't be closed within 14 days. This procedure ensures that all correspondence receive a written acknowledgement within 14 days upon receipt in the service centers.

- Required taxpayer accounts be frozen to stop erroneous notices and refund offsets until the requested adjustment action can be completed.

- Increased the number of telephone lines available for tax assistance by 11% over 1985.

- Expanded circuitry for multifunctional equipment (MFE) systems which provide recorded tax and refund information to taxpayers. Nationwide toll-free service for MFE was also implemented for the first time in January, 1986.

- Ensured that taxpayers who call the Service for help receive needed assistance with one phone call. Instead of asking taxpayers to call back if our referral account lines are busy, taxpayer assistors promptly reply to a taxpayer's inquiry with a call back or written response.

SENATOR ABDNOR: In its testimony of December 16, 1985, before the House Subcommittee GAO stated:

> "One of the steps IRS took in an attempt to reduce its correspondence inventories to manageable levels was to

> increase several of its tolerances so as to reduce the number of taxpayer accounts needing adjustment and thus the volume of taxpayer correspondence".

How did IRS decide which tolerance to change and by what amount?

MR. EGGER: IRS implemented various procedure and tolerance changes in 1985 as a result of an Executive Conference held on July 29-31, 1985, and recommendations made by the Philadelphia Service Center Top Level Task Group. Tolerances selected for revision were those which would provide the greatest relief to our inventories with the least impact on voluntary compliance.

SENATOR ABDNOR: What was the actual dollar amount lost to the government as a result of those tolerance changes?

MR. EGGER: The actual dollar amount lost to the government as a result of these tolerance changes has not been determined. We have estimated loss revenue of $110 million as a result of the increase in tolerance for the Federal Tax Deposit Penalty. The remaining tolerances are being reviewed to determine what effect they had on 1985 processing and to determine our needs for 1986.

SENATOR ABDNOR: Assuming a smooth 1986 processing year, will the increased tolerances be reduced to the pre-August 1985 levels?

MR. EGGER: We are in the process of reviewing the impact of these tolerance changes on our 1985 processing to determine if any changes should be made for 1986.

OVERTIME USAGE

SENATOR ABDNOR: Overtime usage for the period January 1 through September 30 at the ten service centers increased from 606 staff-years in 1984 to 869 staff-years in 1985, an increase of 43.3 percent.

What were the actual overtime costs in fiscal year 1985? What overtime costs does IRS anticipate at the service centers in 1986?

MR. EGGER: The actual service center overtime costs for fiscal year 1985 were 963 staff-years and $22,768,372. IRS anticipates overtime in the service centers in FY 1986 will total 973 staff-years and $24,401,000. These figures are for the budget activity covering returns processing.

SENATOR ABDNOR: What efforts is IRS taking to reduce the extent of overtime?

MR. EGGER: Our FY 1986 Financial Plan provides approximately the same level of overtime as used in FY 1985, however, the focus or use of the overtime will differ in FY 1986. Last year the Service expended much of the overtime in the initial processing of the tax returns and correcting the errors detected in the initial processing. For FY 1986, as I have reported earlier, we have carried forward in this year high inventories in the non-pipeline areas, i.e., adjustments, correspondence and unpostables. To work these inventories down to acceptable levels we have elected to use overtime, thereby utilizing the existing skills in the centers, avoiding hiring and training new personnel. We believe that since the high non-pipeline inventories will only be of a short duration, the approach is the most cost effective.

In the pipeline areas, the centers have increased the numbers of personnel in an attempt to minimize overtime usage. Staffing (personnel employed) in FY 1986 should increase by approximately 4,600 over FY 1985.

PRODUCTIVITY

SENATOR ABDNOR: Productivity at the ten service centers declined 18.3 percentage points during the first six months of 1985 compared to the first six months of 1984.

What is IRS doing to improve productivity of its service centers?

Can IRS realistically improve productivity at its service centers without sacrificing quality?

MR. EGGER: Increased and continuing emphasis on quality can only help to improve productivity at the service centers in the long run. High productivity has always been the way of life at IRS; however, in light of the Service's recent problems, we are concentrating on maintaining a quality-conscious environment -- in other words, doing it right the first time. The elimination of duplicate processing will only improve service center production. Quality will not be sacrificed at the expense of high productivity.

Through the use of enhanced quality improvement reports and a comprehensive analysis of all the data we have available to us, the identification of potential problems can be detected early and subsequently resolved early. Specifically, the Program Analysis System (PAS) was developed as a methodology for product review and for identifying systemic deficiencies and providing a basis for measuring a program's effectiveness. PAS locates taxpayers' and processing errors and the reason(s) for their occurrence. Solutions are relatively easy to identify once the specifics of the errors are known.

SENATOR ABDNOR: Are quality standards established for each service center processing activity that has a production standard?

MR. EGGER: Each service center establishes its own Acceptable Quality Standard (AQS) for major programs, which are monitored by the Service Centers' Quality Assurance Branches. The Quality Standard is determined by, but not limited to, the following criteria:

- comparable prior history information
- known systemic/procedural changes

- impact on taxpayer relations
- impact to other service center operations, or
- achievable/desirable quality standards

National Office has developed Quality Indicators which will provide the service centers with a vehicle for comparing the quality of the products produced to a national quality range.

UNIDENTIFIED REMITTANCES

SENATOR ABDNOR: In 1985, service centers received unidentified remittances. Unidentified remittances are payments, which for some reason or another can not be identified with a specific taxpayer's account. Once a remittance becomes a year old, IRS includes it as an excess collection.

What was the national volume and dollar total of excess collections at December 31, 1985?

MR. EGGER: We do not track the volume of excess collections. We do, however, track the dollar amount which was $158,197,828.97 on December 31, 1985.

SENATOR ABDNOR: What other items, if any, are included in excess collections, and what were their volume and dollar total at December 31, 1985?

MR. EGGER: In addition to the unidentified payments mentioned in your introductory remarks, excess collections contain a small amount of tellers' overages and unapplied credits cleared from the master files when the statute of limitations expires. As an example of the latter item, a business taxpayer may have made payments toward an employment tax return which was never filed. IRS makes attempts to contact the taxpayer. If these are unsuccessful, and the statute expires, an excess collection results.

Volume and dollar information about the various types of items in excess collections have not been captured.

SENATOR ABDNOR: What measures are taken to resolve taxpayer payments identified as excess collections?

MR. EGGER: IRS makes repeated efforts to correctly apply taxpayer payments during the year before placing them into excess collections. These measures include researching records and attempting to reach the taxpayer by mail and telephone. Once an amount is moved to excess collections, the supporting files are available for reference, should the taxpayer subsequently inquire about the payment.

LOST RETURNS

SENATOR ABDNOR: In 1985 there were numerous allegations that IRS lost tax returns and payments. IRS, on the other hand, has stated that no returns were lost or destroyed, although IRS has recognized that it temporarily could not find some returns.

Does IRS expect to receive more certified or registered mail this year as a result of last year's processing problems? Would the increased use of certified/registered mail cause IRS to expend additional resources and/or result in extended processing?

MR. EGGER: IRS does expect to receive more certified or registered mail this year as a result of last year's processing problems. The U.S. Postal Service, CPA's and return preparers encourage the mailing of returns in this manner, and we expect the volumes received to increase in 1986. This increase may cause IRS to expend additional resources. However, since this is an automated process, the increased cost and time should be minimal.

SENATOR ABDNOR: Has IRS established a system to acknowledge that a taxpayer's return has been received at a service center?

MR. EGGER: No, the Service does not have a system which can inform taxpayers whether or not a service center has received a return. However, as of March 17 a special Fact-of-Filing (FOF) system enables our assistors to tell taxpayers who have filed other than fully paid returns when those returns entered the processing system. The FOF system is a response to one of the Service's processing problems in 1985. Last year, we asked many taxpayers to file duplicate returns because our records did not show that the original entered the processing system within the usual time frame.

SENATOR ABDNOR: Taxpayers can call IRS after several weeks to determine whether their refunds have been mailed. Last year, IRS' system provided a phone message to taxpayers to tell them about the status of their refunds. However, the recorded message--"there is no record of your return"--gave taxpayers the impression that IRS had not received their return when, in reality, all the message meant was that the return had not yet processed. Has IRS improved the content of this year's message to taxpayers?

MR. EGGER: Yes, taxpayers calling the IRS for information about their refunds in 1986 receive a more complete recorded message. If our service centers have no record of a return on file for a taxpayer, the caller hears the following message: "Your return has not been processed as of this date at (the center serving the taxpayer's locale). Please allow seven days before checking again on the status of your refund. If it has been more than 10 weeks since you filed and you have not received any correspondence about your return, or you filed at another service center, please contact our federal tax information number."

TAX-EXEMPT ORGANIZATIONS

SENATOR ABDNOR: Tentative estimates from IRS' most recent Taxpayer Compliance Measurement Program (TCMP) relating to tax-exempt organizations indicate an unrelated business income (UBI) tax gap lower than the $109 million reported by IRS for tax year 1981 in its July 1983, Income Tax Compliance Research Report.

Now that the final phase of the TCMP has been completed, what is the apparent trend in the UBI tax gap?

MR. EGGER: The initial estimate of unreported unrelated business income tax was based on the voluntary compliance levels determined from examinations of the 1973 and 1974, Form 990 and 990-PF returns of private foundations, public charities and social welfare organizations exempt under Code sections 501(c)(3) and 501(c)(4). The expanded TCMP survey of 1981 through 1984 returns that was completed in March, 1985, included examinations of organizations recognized exempt under Code sections 501(c)(3) through 501(c)(8) filing Form 990 and 990-PF returns. Although the data from this survey indicates a tax gap lower than that previously reported, it is difficult to assign a certainty to the data as it does not represent the entire exempt organization universe and excludes in particular those organizations with income or assets of $50 million or more.

SENATOR ABDNOR: As a result of this trend, what changes, if any, are anticipated in IRS' monitoring and enforcement policy?

MR. EGGER: Although our recent TCMP was not specifically designed for unrelated business income, the information that was gathered is being used to identify areas of non-compliance and to develop initial 990-T filer and non-filer profiles.

SENATOR ABDNOR: During the fiscal year 1986 appropriations hearings, IRS reported that additional data was needed to measure the UBI tax gap more precisely. Additionally, GAO, in a July 1985 report, identified this same need and recommended that IRS develop, collect, and analyze information on UBI activities to more completely understand UBI tax noncompliance and to better focus examinations on organizations with high potential for non-compliance.

What plans does IRS have to develop such information?

MR. EGGER: As previously stated, the limited data collected during the recent TCMP is being used to develop Form 990-T filer and non-filer characteristics. Also, a TCMP of Form 990-T will be conducted to collect and analyze UBI activities. All filed Forms 990-T will be sampled for this study.

SENATOR ABDNOR: What are the time-frames for any proposed efforts?

MR. EGGER: The development of filer and non-filer characteristics is currently underway and should be completed by late summer. The Form 990-T TCMP will be conducted on calendar year 1986 and fiscal year 1987 returns. Examinations are scheduled to begin in October 1987 and will be completed March 31, 1989.

SENATOR ABDNOR: The Small Business Administration and various trade and professional associations have begun to question the activity of many tax-exempt organizations seen as openly competing with taxable businesses.

Does IRS see a trend toward increased dependence upon commerical competitive sources of revenue by tax-exempt organizations?

MR. EGGER: We have no firm data and statistics on this.

SENATOR ABDNOR: What is the general nature of the activities giving rise to this revenue?

MR. EGGER: As mentioned, there is very little if any firm data that has been collected in this area to rely on.

SENATOR ABDNOR: What consequences could these activities and revenue have upon the tax-exempt status of the organization?

MR. EGGER: In most cases, the organization would be taxed on the unrelated trade or business income, and the tax-exempt status would remain unaffected. The primary purpose of the enactment of the unrelated business income tax provisions was to eliminate unfair tax advantages that would otherwise be afforded to exempt organizations over competing for-profit organizations. Generally, under current law, the carrying on of unrelated trade or business is consistent with the exempt status of most categories of exempt organizations, although income from such activities is subject to taxation. Nevertheless, if the Service determines that unrelated trade or business is in fact the primary purpose of the organization, denial or revocation is appropriate.

SENATOR ABDNOR: The UBI tax is intended to eliminate any unfair advantage afforded tax-exempt organizations conducting substantially unrelated activity in competition with taxable businesses. In the fiscal year 1986 appropriations hearings, IRS made reference to some accounting and definitional problems in administering this tax.

What accounting and definitional problems is IRS currently experiencing in this area?

MR. EGGER: As we indicated in the fiscal year 1986 appropriations hearings, we experience accounting problems in situations where the facilities and personnel of an exempt organization are used to carry on exempt functions and to conduct unrelated trade or business. We cited the allocation problems arising from Renssalaer Polytechnic Institute v. Commissioner, 732 F. 2d 1058 (2nd Cir. 1984) in which an exempt organization was allowed to allocate its indirect expenses such as depreciation between exempt and taxable activities on the basis of the actual hours its fieldhouse was used for each activity, rather than the total time the facility was available for use; thus, in our view, artificially increasing the allowable deduction.

In addition, in American Bar Association v. U.S., 84-1 U.S.T.C. ¶9179, 63 A.F.T.R. 2d 851 (D.C., Ill. 1984), the ABA's Fund for Public Education was allowed to be included in the Services's allocation formula used to determine the ABA's income from periodicals, thus lowering the ABA's tax on unrelated business income. The Service had unsuccessfullly argued that since the Fund for Public Education was a distinct entity separate and apart from the ABA, the two entities should not be considered together in determining the tax.

More recently, the Sixth Circuit in Cleveland Athletic Club v. U.S., 779 F. 2d 1160 (1985), held that an exempt social club was entitled to offset its losses attributable to food and beverage sales to nonmembers against its investment income, thus overruling the Service position of Rev. Rul. 81-69, 1981-1 C.B. 351, that activities that are not profit-motivated cannot be netted against taxable income from profit-motivated endeavors. The case is virtually impossible to reconcile with a tax court decision favoring the Service in The Brook, Inc. v. Commissioner, 51 T.C.M. 1985-614 (1985).

Definitional problems arise because differentiating between exempt activities and unrelated activities often entails difficult judgments about a wide variety of activities. In the fiscal year 1986 appropriations hearings, we cited the case of The American College of Physicians v. U.S., 743 F. 2d 1570 (Fed. Cir. 1984), involving the sale of commercial advertising in a medical journal published by an exempt organization. The case is currently being considered by the Supreme Court. The Service position is that (with a few minor and specific exceptions) all commercial advertising in exempt organization periodicals is unrelated trade or business, but the Federal Circuit would require the Service to evaluate the informational content of each advertisement to determine whether each is related or unrelated to the organization's exempt purpose. Distinguishing between advertisements that have "commercial" content and those that have "educational" content will pose difficult definitional problems.

SENATOR ABDNOR: What effect are these problems having on IRS administration of the UBI tax?

MR. EGGER: A loss of American College of Physicians v. U.S. in the Supreme Court would make many unrelated business income tax provisions virtually unenforceable, particularly the section 513(c) provisions with respect to taxation of advertising income. Such a result would open a serious loophole in an important area of the unrelated business tax provisions. In other cases, time-consuming examinations have been required where there has been a mix of exempt and unrelated activities. For example, a museums's gift shop may sell merchandise that directly furthers the museums educational purposes, but may also sell items that have little educational value and only marginal relation to the subject matter of the museum's collections. A tedious and potentially contentious item-by-item examination of the gift shop's lines of merchandise is often required.

SENATOR ABDNOR: What action, if any, is IRS taking to address these problems?

MR. EGGER: The Service seeks to identify and resolve significant new or recurring unrelated business income tax issues in order to give its field personnel and the general public guidance in handling accounting and definitional problems. Generally, this has been done through the Service's publication of revenue rulings. Last year, for example, we published two revenue rulings concerning the tax treatment of income from testing of laboratory specimens from nonpatients by tax-exempt hospitals. The Service position announced in the revenue rulings is that in most cases the testing of specimens from persons who are not patients at the hospital doing the test is unrelated to a tax-exempt hospital's exempt purposes even though the persons may be private patients of staff doctors. (Cf. St. Luke's Hospital of Kansas City v. U.S. 494 F. Supp. 85 (W.D. Mo. 1980)).

TELE-TAX SYSTEM

SENATOR ABDNOR: As mentioned in the fiscal 1986 House Appropriations hearings, during 1984, IRS received over 3.4 million calls on the Tele-Tax system and expected 3.5 million calls to the system in 1985. Furthermore, IRS surveys showed that 37.4 percent of all callers to the system in fiscal year 1984 received a complete answer to their question and 46.9 percent received a partial answer.

Did the projected increase in calls to the Tele-Tax system materialize in fiscal year 1985?

MR. EGGER: FY 1985 saw Tele-Tax call volumes increase dramatically. Approximately 8.3 million taxpayers used automated response telephones to receive recorded information on a variety of tax topics and on their refunds.

SENATOR ABDNOR: What percentage of taxpayers received complete answers from the system in fiscal year 1985?

MR. EGGER: Our survey indicates that 51.3 percent of the taxpayers who used the Tele-Tax system in 1985 received complete answers.

SENATOR ABDNOR: What percentage of taxpayers received partial answers from the system in fiscal year 1985? Did IRS' survey determine if these taxpayers would seek out IRS traditional walk-in, correspondence, and toll-free assistance programs to get a complete answer? Did the surveys determine what improvements could be made to the system to provide a higher percentage of complete answers?

MR. EGGER: Our survey indicates that 26.9 percent of Tele-Tax callers received a partial answer in 1985. The survey is designed only to measure caller satisfaction with Tele-Tax. It counts those who are totally satisfied, partially satisfied, and dissatisfied with the recorded information; it does not attempt to determine if those receiving less than complete answers would seek traditional IRS assistance programs for more tax information. Neither does the survey ask callers to suggest specific ways to improve the quality of service offered by Tele-Tax. However, if large numbers of taxpayers express dissatisfaction with a particular recorded tax message, we will revise its script in an attempt to provide more complete and helpful information.

COLLECTION RELATED TASKS

SENATOR ABNOR: Taxpayer Service personnel currently can make payment arrangements with taxpayers. This is an activity previously performed only by Collection personnel.

To what extent are Taxpayer Service personnel now performing account-related tasks that were previously performed by Collection personnel?

MR. EGGER: Taxpayer Service personnel have been authorized to grant installment agreements for several years. Prior to 1983, this authority was generally limited to relatively low dollar level accounts. In May 1983, the notice authority was expanded and handling Tax Delinquent Investigation notices was added for the first time. The duties have been revised on several occasions and the latest revision was issued February of this year. Under these guidelines, Taxpayer Service employees may grant short-term extensions of time to pay; grant installment agreements for up to 12 months to individual taxpayers; and handle tax delinquent investigation inquiries and accept delinquent returns.

SENATOR ABNOR: To what extent are Taxpayer Service personnel trained in performing Collection activities?

MR. EGGER: The notice account training is incorporated in Taxpayer Service notice inquiries training and is mandatory for all new employees.

SENATOR ABNOR: How many IRS staff are performing the dual role of Taxpayer Service and Collection?

MR. EGGER: Specific instructions regarding which employees perform the work have not been issued. In some districts all employees handle the duties; in other sites they may be assigned to specific employees. Regions and Districts are not required to report the number of assistors performing the duties, so this information is not available.

TAX REFUND OFFSET PROGRAM

SENATOR ABDNOR: During the fiscal year 1986 hearings before the Appropriations Committees, IRS submitted data to show that it expended about 39 staff years on essentially non-tax functions. This expenditure of staff years was for the Child Support Refund Offset Program.

Further, under a recently announced program, IRS will offset income tax refunds on student loans authorized by the Department of Education; and loans granted by the Housing and Urban Development Department, Veterans Administration, Small Business Administration, and the Department of Agriculture.

As a result of adding these new programs, how many staff years does IRS expect to spend in fiscal years 1987 and 1988 on essentially non-tax functions?

MR. EGGER: In fiscal year 1986, the Service has projected an expenditure of 89 staff years to administer the Tax Refund Offset Program. This projection is based on 2,255,793 cases submitted by the Agencies; 1,505,332 from Health and Human Services, and 750,461 from the other Agencies. To project the staff year expenditures for fiscal year 1987 and 1988, we would need to know the volume of cases each agency expects to submit. If the volume remains relatively the same as fiscal year 1986, our expenditure would basically remain the same.

SENATOR ABDNOR: How does IRS handle taxpayer complaints relative to such offsets?

MR.EGGER: As in any program of this size and complexity, some errors are bound to occur. When disputes do arise, the Service refers the taxpayer to the Agency which certified the debt to us originally. This referral is made because the IRS has no independent method of verifying the taxpayers' claims.

SENATOR ABDNOR: To what extent has IRS erroneously applied refund offsets?

MR. EGGER: Statistics from the Child Support Refund Offset Program indicate that out of 1,517,953 offsets made from 1982 through September 1985, only 32,216 or 2.1 percent resulted in any adjustment action.

SENATOR ABDNOR: Can IRS estimate the extent of offsets that will occur, by program, in fiscal years 1987 and 1988 and the associated cost of making these offsets?

MR. EGGER: IRS cannot estimate the number of offsets for fiscal years 1987 and 1988 at this time. To perform such an estimate, we must know the expected number of cases to be submitted by each participating agency, and have the results of the 1986 program. For the fiscal year 1986, IRS based the projected cost and staff utilization on the experience gained from the Child Support Refund Offset Program. We estimated that 33 percent of cases submitted would result in an offset. The cost for the 1986 program is $3.78 per offset. The results of the 1986 program will be monitored and evaluated to establish whether this cost should be adjusted for the 1987 program. If the overall number of cases submitted from all agencies in 1987 remains substantially the same as for 1986, the cost per case offset should remain substantially the same, with some adjustments for any increase in federal salary scale.

SENATOR ABDNOR: Is IRS fully reimbursed from the applicable federal programs for the cost it incurs to offset refunds? If not, why not?

MR. EGGER: Yes, IRS is reimbursed at a rate of $3.78 for every offset performed. This cost includes all associated costs for handling taxpayer inquiries and processing Injured Spouse Claims.

Senator ABDNOR: During last year's appropriations hearings, IRS said it would shortly have more conclusive results to share as to whether taxpayers were adjusting their yearly withholding to ensure that there was no refund to offset. Is this study completed and, if so, what are IRS' findings?

Mr. EGGER: This study, which addresses AFDC child support offsets, will be completed this summer. It will address any impact of refund offsets on withholding.

QUESTIONS SUBMITTED BY SENATOR DENNIS DECONCINI

UNFILLED POSITIONS

SENATOR DECONCINI: Commissioner, IRS is requesting an additional 5,788 full-time, permanent positions over fiscal year 1986 appropriated levels. Yet your table on page 8 of the justifications show that you will have 1,708 unfilled positions at the end of FY 1986 and 1,775 unfilled positions at the end of fiscal year 1987.

Why in the world should we give you more than three times the number of unfilled positions next year, if you consistently don't staff up to authorized levels?

MR. EGGER: Unfilled positions reflect normal turnover in staff, as retirements and resignations occur. Since these positions are filled competetively, IRS has, at any given time, a number of vacant positions for which selective placement actions are in process. The vacancy rate - about 2% - is not unusual for an organization of our size or complexity. The increase in permanent positions (+5,788) requested are related to the revenue initiative (+3,326), tax shelter initiative (+479), document matching initiative (+419), CTR processing (+270), processing additional returns (+249), service center computer room staffing, and improved service center operations (+783).

INCREASE IN STANDARD LEVEL USER CHARGES

SENATOR DECONCINI: Commissioner, you are asking for a $34.8 million increase in standard level user charges, or SLUC. This increase alone would be enough to fund the entire Office of Management and Budget for a full year. Why are you faced with such a large dollar increase for SLUC next year -- about 15% over 1986 levels.

MR. EGGER: The increase in standard level user charges results from (1) an increase of 7.5% ($16 million) to cover GSA reappraisals and the related rate increases on existing space; (2) additional off-site space at service centers to store potentially active tax returns and related documents, and to house employees for remote job entry, required because of difficulty in attracting sufficient numbers of skilled workers at our existing service center locations ($7 million); and (3) the need to acquire space in our 63 districts to house the additional employees requested to examine tax returns and close tax shelter cases ($12 million).

TRANSFER AUTHORITY

SENATOR DECONCINI: Commissioner, you are requesting authority from this Committee to allow IRS to transfer up to 5% from any IRS appropriation account to any other IRS appropriation account. Frankly, I intend to recommend against this transfer authority. No agency needs that kind of discretion to change Congressional priorities. If you need to adjust your appropriated amounts, you should have to come before Appropriations Committees or have adjustments made by an affirmative action by the the Congress.

Why should the Committee approve this overly generous transfer authority?

MR. EGGER: The Internal Revenue Service is one of a few agencies with separate appropriation accounts for it's normal operations. In effect, this requires management of IRS resources as though it were four separate agencies. Budget estimates are developed a full year in advance of the fiscal year starting, and two years before the moneys are fully spent. While we strive to make our budget forecasts as accurate as possible, we cannot anticipate every change in circumstance, costs, or workload. We believe it is reasonable and appropriate that the Service be authorized an adequate measure of flexibility to transfer funds to deal with unforeseen conditions. Limited authority of only 5% to transfer funds among the four accounts is essential for us to administer effectively an extremely complex tax system and to achieve the program objectives intended and approved by the Congress. This limited authority is even more critical in circumstances of extreme budget fluctuation and uncertainty. For example, at the midpoint this year IRS must make significant cuts due to Gramm - Rudman - Hollings. Without this authority, cut backs would be required in our front-line operations, including taxpayer service, processing tax returns and issuing tax refunds. Certainly any major adjustment, beyond 5%, should require an act of Congress.

OFFICE ALTERATIONS

SENATOR DECONCINI: Commissioner, you indicate in your justifications that Gramm-Rudman-Hollings will mean that the agency will have to "suspend office alterations".

Could you elaborate on what office alterations you have planned or ongoing at the IRS; how much you spent or intend to spend; and exactly where this renovation is or was taking place? Be specific and provide details for the record.

MR. EGGER: The FY 1986 budget contains about $26 million for space and housing alterations. Each year the Service budgets these funds for our offices to accommodate alterations which can improve workflow, enhance communication, provide better utilization of available space or allow for the release of space. Also, these monies provide for repair and physical restructure of our facilities to meet maintenance, security and health and safety requirements.

To accomplish the Gramm-Rudman-Hollings reductions, we have suspended over $7 million or about 30 percent of our office alteration projects. Some examples of deferred projects include: the replacement of the raised flooring that has collapsed in several places in the remittance processing area of the Cincinnati Service Center; a space realignment at the Rockford office which would release 2,000 square feet of space; the installation of a security alarm system in Criminal Investigations Division, Chicago District Director's complex and all public contact areas; and space alterations that would release 2,400 square feet in the Central Region.

These projects can be deferred on a one-time basis in FY 1986. However, if these projects are deferred beyond FY 1987 there would be an adverse impact on our costs and operations.

SALARIES AND EXPENSES: INCREASED AVERAGE SALARY

SENATOR DECONCINI: Commissioner, I notice that the average GS salary in your Salaries and Expenses activities and programs has jumped rather dramatically since last year. The average GS salary increases from $23,857 last year to $42,113 next year -- an increase of 76%. Yet your average grade actually declines.

Can you tell the Subcommittee why this huge percentage increase in the salaries paid to personnel covered by your salaries and expenses account?

MR. EGGER: The average GS salary amount for FY 1987 should read $24,113, an increase of only $256, 1%. This increase is due to the pay raise of 3.5% which went into effect January, 1985, offset in most part by our actions to reduce the average grade.

SUPPLIES AND MATERIALS: PROCESSING TAX RETURNS

SENATOR DECONCINI: You are requesting a 28% increase for supplies and materials under Processing Tax Returns -- from $22.7 million in 1986 to nearly $29 million in 1987. I understand why you may need additional personnel to process more returns but why do you need a 28% increase for supplies and materials next year within this account?

MR. EGGER: The increase for supplies and materials totals $6.3 million. Most of the increase is needed to acquire ADP supplies (magnetic tape, high speed computer paper, etc.) used to process tax returns and issue bills and notices. These funds ($6 million) are critical to the tax processing system. Also included is a small amount ($300,000) to cover normal inflationary cost increases for office supplies.

EXAMINATION AND APPEALS APPROPRIATION TRAVEL

SENATOR DECONCINI: Your travel budget under Examination and Appeals has increased by nearly 50% since Fiscal Year 1985, while your permanent, full-time positions have increased by 18% during the same period (if we approve your budget).

Why has your travel budget outpaced your increase in staff by nearly three-fold and why do you need a 15% travel hike next year?

MR. EGGER: Our travel needs have increased by $23 million since FY 1985. This is largely due to major initiatives to (1) expand examination of tax returns which will add some $10 billion in additional tax revenue between FY 1987 and FY 1991 ($13 million); (2) expedite resolution of pending tax shelter cases which will accelerate revenue collections by $600 million in FY 1987 ($1 million); and (3) augment examination of domestic corporations having international activity ($1 million). We are also restructuring our basic revenue agent training course, adding a new audit techniques course to strengthen skills in detecting unreported income and instructing revenue agents in the use of portable microcomputers--the basis of automating our examination system ($7 million). In addition to these new initiatives, our budget includes increased travel costs associated with implementation of the Deficit Reduction Act of 1984 (P.L. 98-369) ($1 million).

CONSULTING SERVICES

SENATOR DECONCINI: Throughout the four major appropriation accounts of IRS, you are requesting $4,832,000 for consultant and related services.

In view of the huge increase in personnel of all types in most all of your accounts next year, why shouldn't the Committee eliminate or drastically cutback your consultant services budget? With all of the additional personnel at IRS, shouldn't you be able to do without this level of funding for consultants next year? If not, why not?

MR. EGGER: The Internal Revenue Service frequently uses consultants and experts in projects where sophisticated, specialized knowledges or support services are not available within the agency. To illustrate, IRS has called upon consultants for mathematical modeling to improve resource allocation and operational procedures; determining trends in the nature of international transactions (tax havens); tax forms simplification; analyzing taxpayer reporting burdens; and assessing alternative technologies for delivery of taxpayer service. The funds requested, $4.8 million, maintain these efforts and represent only a small, but important, part of the overall budget.

GRAMM - RUDMAN - HOLLINGS REDUCTION

SENATOR DECONCINI: Commissioner, I was surprised to see in your justification that you are requesting full restoration of the entire "first sequester" cuts imposed under Gramm - Rudman - Hollings. For IRS, that restoration totals over $156 million. You justify this restoration by stating in your budget book that Gramm -

Rudman - Hollings has "only a one-year effect." Where did you get the idea that Gramm - Rudman - Hollings was only a "one-shot" deal? This amendment calls for deep cuts over five years and, although I opposed Gramm - Rudman, I am sure that its authors did not expect the agencies to restore the first sequester in the fiscal year 1987 budget. Why should you or any other agency automatically get its sequester money back?

MR. EGGER: The President's budget request for FY 1987, which includes an increase for the Internal Revenue Service, meets the deficit reduction target ($144 billion) required under Gramm - Rudman - Hollings. The Service is able to cut $156 million on a one-time basis in FY 1986. These reductions to staffing in selected programs, training, office renovations, supplies, selected ADP modernization initiatives, would, if retained in the future (FY 1987 and beyond), cause loss of effectiveness and efficiency in our operations and nullify the priorities of our 1987 budget, i.e. significantly increase revenue collections and assure improved processing and taxpayer service.

SUBCOMMITTEE RECESS

Senator ABDNOR. If there is no further business to come before the subcommittee today, we will stand in recess until 10 a.m., Tuesday, March 18, when we will hear from the Postmaster General. Thank you.

[Whereupon, at 4:55 p.m., Thursday, March 13, the subcommittee was recessed, to reconvene at 10 a.m., Tuesday, March 18.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

TUESDAY, MARCH 18, 1986

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:15 a.m., in room SD–124, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor and DeConcini.

U.S. POSTAL SERVICE

STATEMENT OF ALBERT V. CASEY, POSTMASTER GENERAL

ACCOMPANIED BY:
- JACKIE A. STRANGE, DEPUTY POSTMASTER GENERAL
- LOUIS A. COX, GENERAL COUNSEL
- WILLIAM CUMMINGS, SENIOR ASSISTANT POSTMASTER GENERAL FOR FINANCE

PREPARED STATEMENT

Senator ABDNOR. The subcommittee will come to order.

This morning we will continue our hearings with testimony from the Postmaster General, Albert Casey. It is a real pleasure to welcome you to our committee. I know this is your first appearance. And we are looking forward to hearing from you. From what I understand, maybe your last, too. I hope not. The rumor is that you are just doing this for a short time.

But we are looking forward to working with you for whatever period it is. Your reputation is well known, and everyone is hoping you will stay with us for awhile.

But anyway, I am already late and taking your time, so I am going to dispense with any opening statement. I notice you have a very short written statement. You can either read it——

Mr. CASEY. I will be glad to submit it.

Senator ABDNOR. We will be happy to place it in the record as though read.

[The statement follows:]

STATEMENT OF ALBERT V. CASEY

Mr. Chairman, for fiscal year 1987, the President has recommended an appropriation to the Postal Service of $40,049,000. This is a reduction of $707,951,000 from the amount appropriated by the continuing resolution for fiscal year 1986.

PUBLIC SERVICE APPROPRIATIONS

The Postal Service has not received a public service appropriation since fiscal year 1982. And we are not requesting one this year.

TRANSITIONAL APPROPRIATION

The $40,049,000 request for fiscal year 1987 is for payment to the Labor Department. This item covers certain workers' compensation liabilities of the U.S. Government. These arose from disabilities suffered by employees of the former Post Office Department, prior to the creation of the Postal Service in 1971. For fiscal year 1986 the Congress did not provide this appropriation. There was evidently some expectation that the Postal Service could cover the needed payment itself.

By law, these Post Office Department liabilities remain the responsibility of the United States and not the Postal Service. The Postal Service and ultimately the postal ratepayer are required to cover the full cost of workers' compensation attributable to current operations. But the laws recognize that present ratepayers should not have to bear an added burden, left over from deficit operations before the Postal Service was created. In this one respect the Postal Service is in much the same position as other agencies. We must rely on the annual appropriation request for funding to cover this worker's compensation billing from the Department of Labor.

REVENUE FORGONE

The President has recommended no revenue forgone appropriation. This appropriation would support free mail and certain reduced postage rates. The budget submission indicates that the administration will submit legislation on this subject. It will propose continuing most of these subsidies by requiring the Postal Service to fund them through general postal revenues. Our position has been that if the Congress wants to have postage subsidies for some mailers, it should fund them.

The total funding necessary for fiscal year 1987, to keep these rates at currently authorized levels, would be $833,211,000. This amount is the revenue loss from having the reduced rates instead of the regular rates which would apply if subsidies had not been authorized. Under current law, if Congress decide not to provide the full appropriation, the Postal Service adjusts the reduced rates to make up the shortfall.

Mr. Chairman, I shall be pleased to respond to any questions.

PREFERRED PRICE LEVELS AND PERCENTAGE INCREASES FISCAL YEAR 1986 ILLUSTRATIVE EXAMPLES[1]

		March 9 to September 30[2]		Regular (Commercial)	
	Step 16 prices	Prices	Percentage increases[3]	Prices	Percentage increases[3]
	Cents	*Cents*	*Percent*	*Cents*	*Percent*
Second-class publications:					
In county	6.3	7.3	16	10.6	68
Nonprofit	8.2	8.8	7	10.6	29
Classroom	11.2	13.4	20	19.6	75
Limited circulation	9.3	9.9	6	11.6	25
Science of agriculture	10.8	11.0	2	11.6	7
Third-class nonprofit:					
Carrier route presort	4.8	5.7	19	8.3	73
Presort to five digits	6.3	7.2	14	10.1	60
Required presort	7.4	8.7	18	12.5	69
Fourth-class library rate	67.0	74.0	10	94.0	40

[1] See following for "Illustrative examples."

DESCRIPTION OF ILLUSTRATED PREFERRED RATE EXAMPLES

SECOND-CLASS PUBLICATION

In county:
  Rural newspaper:
    Weight: 4 ounces
    Advertising: 50 percent
    All delivered in county
    Presorted to five digits
Nonprofit:
  Veteran's magazine:
    Frequency: Monthly
    Weight: 4 ounces
    Advertising: 20 percent
    New York to Chicago
    Presorted to five digits
Classroom:
  Classroom publications:
    Frequency: Weekly
    Weight: 12 ounces
    Advertising: 15 percent
    New York to Chicago
    Thirty-two copies per piece
Science of agriculture:
  Rural agricultural newspaper:
    Frequency: Weekly
    Weight: 4 ounces
    Advertising: 50 percent
    Within 150 miles of entry
    Presorted to five digits
Under 5,000 copies:
  Newspaper:
    Frequency: Weekly
    Weight: 4 ounces
    Advertising: 50 percent
    Within 150 miles of entry
    Presorted to five digits

THIRD-CLASS NONPROFIT

Fundraising letter:
  Weight: 3/4 ounce
  Nationwide distribution
  Carrier route presort
  Presorted to five digits
  Required presort

FOURTH-CLASS LIBRARY RATE

Book between libraries:
  Weight: 2 pounds
  New York to Chicago

[2] Possible prices during the specified time period. Includes adjustments for the current appropriation shortfall plus the Gramm-Rudman reduction.

[3] Percentage increases are from step 16 prices which were in effect from January 1 to March 8.

INTRODUCTION OF ASSOCIATES

Senator ABDNOR. Why do you not go ahead and introduce your colleagues.

Mr. CASEY. Mrs. Strange to my right is the Deputy Postmaster General; General Counsel Lou Cox over here; and Bill Cummings, our chief financial officer is on my left.

POSTAL SERVICE REALIGNMENT

Senator ABDNOR. We welcome you all.

All right, I do have a few questions I might ask. And then maybe we will submit some for the record. And if all hearings will go as smooth as I know this one is going to go, the Government would be in good hands.

Since becoming the Postmaster General you have made several changes in your organizational structure. Could you just briefly describe those changes.

Mr. CASEY. I'll be glad to. We had two structural changes, one in what we call the field, one in the headquarters. Speaking briefly about the one in the field, you have to understand how we were originally set up. We had approximately 30,000 post offices out in the field. And they were reporting to a combination entity called a management sectional center. And there are 220 of those. And they are grouped over the 30,000 post offices.

Grouped over the management section centers are 41 district offices. Then over the 41 district offices, there are five regions. And then those five regions are headed by Regional Postmaster Generals, who report to Mrs. Strange.

So we have a regular tent effect going down from the regional office through various levels of authority and control down to the post office.

Senator ABDNOR. That is the way it was?

Mr. CASEY. That is the way it was. The way it is now, there have been no changes in the 30,000 post offices. They are still out there. No changes in their personnel or facilities at all. Over them where we had the 220 management sectional centers, we will now have about 80. Basically they will be 80 of the largest. And the 140 sectional centers that did not qualify as 1 of the 80 will be reporting to the 80.

Senator ABDNOR. Will they change substantially from what they are now?

Mr. CASEY. There will be some changes, yes. I will try to explain——

Senator ABDNOR. OK, I'm sorry.

Mr. CASEY. No, no; that's all right. In those 140 that are going to report to the 80 largest, some of their personnel will flow up to the 80. The 41 district offices will disappear entirely and their personnel capacities will come down into the 80 large sectional centers. Above those district offices--I mean the district offices which are now gone, are the five regional offices which had approximately 374 people in each office. That complement will drop down to about 70 people in each regional office.

So we will be taking the extra people out of the regions and out of the districts and out of the extra MSC's and staffing these 80 units. They are called Division MSC's now. Each of them will be the equivalent of a freestanding, wholly owned subsidiary, if you will, with their own chief executive officer, their own capacities, and their own authorities.

The whole purpose of this is to make the field, the service, more responsive to its public. Because in the past, for example, it took 8 years to get a post office built. You had to go through many levels of authority. Naturally they all performed very well, but each one proved his own importance by raising a series of questions. The authority levels had to go back and forth from the post office to the MSC to the district to the region to headquarters and back down to answer the questions.

POSTAL SERVICE REALIGNMENT

Now, those divisional MSC's will be freestanding companies with practically all the capacities. The staff complement of the regional offices went from 370 to 70, and will be like the chairman of the board situation. They will transmit to headquarters the needs, requirements, provisions, and plans that have been sent to the 80 MSC's.

At headquarters we are going to maintain two shifts. There were eight departments that reported to me individually, personnel, planning, finance, and five others. Mrs. Strange had about eight departments reporting to her, plus the five regional PMG's, a span of control I do not believe is appropriate.

Today, as Deputy Postmaster General, Mrs. Strange has reporting to her the five regional PMG's who are the conduits down to these 80 MSC's in the field and one operational staff support unit which provides help for today's technology in the field. They are not developing new systems and new technologies, new marketing plans. They are helping the operational requirements in the field.

Over to the side, I have appointed an Associate Postmaster General. And that gentleman has reporting to him all the staff services such as marketing, data processing, personnel, labor relations, all the things that deal with the future of the post office. They evolve the plans and the products, the treatments, and they package up the programs. And they are transmitted to the field through Mrs. Strange. By the same token, they respond to the questions from the field.

That is a long winded way of saying we have eliminated several review areas, and we have much more direct responsiveness now in headquarters. The goal is not to close post offices—we did not close a one. The goal is not to release people—not one person is losing his or her job. The job is not to demean anybody. The job is to get the public served better.

We really genuinely believe it will be accomplished. It will be a few months before the final steps will have been accomplished. But that is the principle that's involved.

Senator ABDNOR. You have gone quite a ways already though.

Mr. CASEY. Oh, yes.

FUTURE OF POSTAL SERVICE

Senator ABDNOR. What is the future for the postal services in the years to come?

Mr. CASEY. I think it is just great. I am a big fan of the Postal Service. There are a lot of really dedicated people. You go down to see these people, and you see that these people really take their assignments very seriously. They want that last piece of mail delivered before they go home at night. They respect the security of the mail. They are very proud of their job.

And they work for the only company in America that touches everybody everyday. And I think it is shown by the growth. The growth figures vary from 3 to 6 percent a year for the past 5, 6, 10 years. And we are continuing to grow. And we shall grow.

PRESIDENT'S BUDGET PROPOSAL

Senator ABDNOR. I want to ask you about the President's 1987 budget where he proposes several changes in the contribution formula for retirement. How are they going to affect the Postal Service?

Mr. CASEY. Well, there is no way we can absorb that. That particular one will hit us for about $430 million in fiscal year 1987. There is no way, even if you would approve, and we would approve, and the public would approve, that we could get a postal-rate increase in time for us to absorb that. Our early forecast for the year 1987—this was done several months ago—is that we will lose some $440 million.

So if we put that increased retirement amount on top of that—and there are other pieces that the President is suggesting too—there is no way we could afford it. Now, in the long run, if we are going to be a free-standing, so-called free enterprise institute, we should absorb a group of these costs, pension, health payments, and so forth. But we must be permitted to phase them in. We cannot be hit with them overnight.

Senator ABDNOR. Have you made this known to the OMB?

Mr. CASEY. Several times. I have done it formally and informally. I have sat down with Mr. Miller myself on occasion and I certainly have made our concerns known to him through Congressman Ford and Senator Stevens. And they just really understand that there is no way we can absorb these costs.

I have been been quoted many times on this, and what I would like is for us to get out of the unified budget. Then when we borrow money to build post offices and improve services, we would not be adding to the Federal deficit. But they have got us in there, and they do not want us out because they do not want us competing with the Treasury for funds.

I can go to places that the Treasury does not even know about.

FREE MAIL PRIVILEGES

Senator ABDNOR. You better keep it to yourselves. That is interesting.

I guess you practically told us this in asking my last question about the President's budget. There is only the transitional funding this year, and that means there is no funding being sought for the revenue forgone subsidy. The President stated free mailing will continue for the blind. I have several questions with regard to that subsidy.

Could you describe the legislation the President submitted and give us your reaction to it and how it is going to impact the costs of mail.

Mr. CASEY. Well, he has put in the budget submission the fact that we should continue to extend the subsidy for free mail for the blind. The subsidy primarily takes the form of Braille material being sent from libraries to the blind and being returned. That is the nature of it.

We value the service. It is $36 million a year. The President is asking us just to absorb it. If we absorb it, obviously, because our goal is to break even, we must charge other users of the mail for the cost of providing that service. Then we fall right into the trap that we are not allowed to cross subsidize. I do not see how we can take it on, to tell the truth.

Senator ABDNOR. That is a good question. And we wonder the same thing here and are trying to come up with some of the answers. As you know, everyone in Congress is big on the revenue forgone.

Mr. CASEY. But it is the responsibility of Congress to decide whether certain disadvantaged people should have the benefit of this social benefit. You do not want the Postal Service to pick and choose which ones should get it, and which ones should not get it. But the last time the Congress put it in the legislation, the President vetoed the legislation. So it is a catch 22. Congress does not know what to do about it.

Senator ABDNOR. Covering the blind around $36 million; is that what you are saying?

Mr. CASEY. Yes, sir.

REVENUE FORGONE

Senator ABDNOR. How about the revenue forgone, I don't know what that would be, I mean the whole package?

Mr. CASEY. Well, the whole package would probably be about $900 million. But that is all the blind, the churches, everyone else mailing at preferred rates.

Mr. CUMMINGS. For the next fiscal year, $833 million.

Mr. CASEY. $833 million is our cost, which includes the blind and other nonprofits, churches, that sort of thing. I do not see any way we could take on $833 million.

Senator ABDNOR. Let me ask you this question. If there is no appropriation provided and the legislation is not enacted, what will the rates for current recipients of the subsidy be on October 1? We would like to have a breakout for class for the record if you could submit that to us.

Mr. CASEY. Well, I brought it with me. Roughly their rates go up by about one-third. Would you like several copies?

Senator ABDNOR. We would like one for the record.

Mr. CASEY. Here they are. It will show what they are today, and what the full commercial rate will be.

Senator ABDNOR. You know, you come all prepared. I appreciate this.

Mr. CASEY. You gave me a special advantage.

Senator ABDNOR. Well, this is what we can look forward to and work from.

Mr. CASEY. Yes; but it is quite a substantial increase, particularly percentage-wise.

Senator ABDNOR. It is a continuing problem and very difficult I am sure. You probably talked to Senator Stevens on our side so many times. He really puts a lot of time in this.

Mr. CASEY. That is true.

PRIVATE EXPRESS STATUTES

Senator ABDNOR. Sometimes you feel like you are banging your head against the wall trying to come out with something. But we are going to have to sit down with you some time and come up with a solution.

Quickly on another subject, and then I will not keep you here very long.

Mr. CASEY. It's perfectly all right.

Senator ABDNOR. I have been concerned about mail delivery in rural America. And you know, no one is more rural out here than I am. But there has been a lot of talk about possible repeal of the private express statute. Is there any problem with that repeal?

Mr. CASEY. Well, Jim Miller is the one who is most articulate on it, and I have asked him about his printed articles. He said the most recent one was dredged up some time ago. He had written it at that time he was being cleared to be, I think, with the Federal Trade Commission.

He did not know he was going to get this position. I think he would like to think it through again. Because I went to him and said suppose the private express statutes were gone, and overnight we have 300 postal systems throughout America, everybody is running around delivering mail, not too many in North Dakota or South Dakota, but there are a lot of them in New York, Chicago, and St. Louis.

So I said, now, what happens when Senator Alan Simpson moves from North Big Switch to South Big Switch and he wants to process an address change? Well, he said, we would have to work that out. I said there is no way to do it. What happens to the mail?

We have postal inspectors, some 2,200 postal inspectors full-time, fully qualified policemen. And we are the only agency in the Government that is charged with providing consumer protection by its own department. So I mean there are things there that really have not been talked about.

Senator ABDNOR. That is great. You just mentioned a couple of things that no one else has brought up.

Mr. CASEY. Look at uniform rates. Today you can send a letter from northern Maine to San Diego for 22 cents. You would not be able to do that if the statutes were repealed.

Senator ABDNOR. I know what has happened to airline rates in our State. And I know to send a letter out of there to some place back East would be at quite a price.

Mr. CASEY. The big markets get the bargain and the small cities pay. I was on the other side from Senator Stevens on that particular question.

Senator ABDNOR. I am glad to hear that. I am sure you must have given plenty to Mr. Miller to think about it. And I hope he forgets all about bringing it up again.

Mr. CASEY. He has slowed down.

POST OFFICE CLOSINGS

Senator ABDNOR. Somebody had resurrected that. I had almost forgotten that he had come up with that one time. I was relieved to hear you say you have no plans for wholesale closings of small post offices. That was something I was going to ask you about.

Mr. CASEY. No, no; we believe in uniform service, we are pledged to it, dedicated to it, and we pledge to carry it forward.

POSTAL RATES

Senator ABDNOR. One last question. What is the future on postal rates? We used to have increases you could bank on every 3 or 4 years. What is the current projection for the next raise?

Mr. CASEY. I will say this, I have never heard of rates going down. So I assume that the next step will be consistent with the past steps. But I would think it would not be for a couple of years, providing I do not get lathered with these health benefits and revenue forgone elimination proposals, that sort of thing.

Senator ABDNOR. Yes; that can change plans in a hurry.

Mr. CASEY. Yes.

Senator ABDNOR. Well, you did just a thorough job. You get the questions answered before I can think of them, Mr. Casey.

Mr. CASEY. You are a good friend.

Senator ABDNOR. We look forward to working with the post office, and we are looking forward to working with you. It is always a pleasure.

ADDITIONAL COMMITTEE QUESTIONS

We thank you all very much for being here today.

There will be some additional questions submitted for your response.

Mr. CASEY. Thank you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR MACK MATTINGLY

Question. You mentioned that the appropriations request for fiscal year 1987 for the Postal Service covers certain workers' compensation liabilities of the U.S. Government. What steps have been taken to improve the safety record in this respect, as well as to cut down on the number of accidents, and do you have any figures concerning this?

Answer. Postal safety and health training is provided for managers, supervisors, craft employees, employee representatives, and health personnel. Additionally, the Postal Service and the Occupational Safety and Health Administration [OSHA] continue to work together to provide training at the OSHA Institute for postal maintenance and safety personnel.

The Postal Service places the responsibility for safety performances at the line-management level. The line organization sets safety and health objectives and is held accountable for providing safe and healthful working conditions. Supervisors receive continuous training in this concept and in good safety management practices. The overall safety record of the Postal Service improved during fiscal year 1985.

The total number of accidents reported during that time was 55,208, a 4.5-percent decrease from the 57,801 accidents reported in fiscal year 1984. The total number of occupational injuries was 33,034, a 7.3-percent decrease from fiscal year 1984 and a 14-percent decrease over 1983. Lost workday injuries totaled 19,678 during the fiscal year for a 9.3-percent decrease from fiscal year 1984 and 10.6-percent decrease from fiscal year 1983.

Question. You mentioned in your testimony the revenue forgone subsidy. Do you have any idea what is the number of organizations that presently receive the reduced rate?

Answer. The Postal Service does not maintain records as to the number of organizations that currently benefit from reduced rates, because it would be too burdensome. However, it is estimated that approximately 300,000 organizations have third-class nonprofit permits, and over 30,000 publications receive various second-class subsidies.

SUBCOMMITTEE RECESS

Senator ABDNOR. We are going to recess and we are going to reconvene at 3 o'clock this afternoon to hear from the Secretary of the Treasury.

But we are looking forward to Mr. Baker. We hope things will go as well as they did with you this morning. Thank you very much.

Mr. CASEY. Thank you, Mr. Chairman. It has been a pleasure to be with you.

[Whereupon, at 10:40 a.m., Tuesday, March 18, the subcommittee was recessed, to reconvene at 3 p.m., the same day.]

(Afternoon Session, 3:30 p.m., Tuesday, March 18, 1986)

DEPARTMENT OF THE TREASURY

Office of the Secretary

STATEMENT OF JAMES A. BAKER, III, SECRETARY OF THE TREASURY

ACCOMPANIED BY JOHN F.W. ROGERS, ASSISTANT SECRETARY OF THE TREASURY, MANAGEMENT

PREPARED STATEMENT

Senator Abdnor. The subcommittee will come to order.

This afternoon we will hear from Secretary of the Treasury, Hon. James A. Baker, III. Mr. Secretary, it is good to have you with us. And you too, John. We are looking forward to your testimony. Frankly I do not have any opening remarks.

Senator DeConcini. I have none, Mr. Chairman.

Senator Abdnor. Mr. Secretary, your whole statement will be made a part of the record. Proceed any way you wish.

[The statement follows:]

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STATEMENT OF HON. JAMES A. BAKER, III

I am pleased to appear before this Subcommittee to discuss the operating budget for the Treasury Department for Fiscal Year 1987.

Last month, I appeared before the Senate Budget Committee as one of the President's chief economic spokesmen. We discussed the economy and the Federal Budget. I underscored the importance of a growing economy to improving the budget picture and pointed out that during the current expansion, strong economic growth has been achieved with much less inflation than in the late 1970's. We must strive to extend that good record into the future. Continued economic expansion will require reducing the deficit and balancing the budget by FY 1991. This will not be easy, but the effort deserves strong bipartisan support.

Today I am before you, not as economic spokesman, but as the chief operating officer of one of the Nation's major departments.

For instance, we administer the Nation's tax system, and collect the government's revenues. We manage the government's fiscal affairs, including paying its bills and financing its debt. We manufacture the Nation's currency and coin. We help regulate our country's financial institutions. We process passengers and cargo coming into the country and enforce both import and export laws. We carry out basic federal law enforcement responsibilities, including protecting the President and Vice-President. We participate in efforts to combat illegal drug trafficking, and administer firearms and explosives laws. Finally, we advise the President on monetary, economic, financial and tax policies.

In order to continue to carry out these essential governmental functions, we are requesting a total FY 1987 budget for the Department of the Treasury of $6.0 billion and 129,127 FTE positions. (These funding and staffing totals include $5.6 million and 75 positions for the orderly shut-down of the General Revenue Sharing program. The Appropriations Subcommittee for Housing and Urban Development and Independent Agencies is reviewing that request.)

Our FY 1987 budget request for Treasury operating programs represents an increase of $364 million, or 6.5 percent above the proposed level for FY 1986.

In addition to the request for Treasury operating programs, the FY 1987 Budget includes proposed legislation for $78 million and 1,664 FTE in order to provide for the management and liquidation of the Small Business Administration loan portfolio. This relates to the proposed termination of the Small Business Administration as reflected in the President's Budget. It is our understanding that this request will be taken up by the Commerce, Justice, and State Subcommittee.

Our budget has seven major objectives:

I. At the top of the list is protecting the integrity of the tax administration system.

The experiences of the 1985 tax filing season were deeply troubling to the Department and a source of great frustration to the taxpaying public. It is my belief that a recurrence of the problems that plagued the IRS last year would have a corrosive effect on our society and a devastating impact on the willingness of our citizens to comply with the system. This erosion of public confidence has a big price tag: a one percent drop in voluntary compliance results in a revenue loss of almost $6 billion. This is clearly a case where an ounce of prevention is worth a pound of cure.

We have reviewed closely the requirements for tax processing and taxpayer service and have developed appropriate requests for FY 1986 and FY 1987 to address these needs. We have designed our budget requests to revitalize the tax system and restore public confidence in its effectiveness. We learned a lesson from last year and intend to ensure adequate funding and to stretch each dollar to its fullest.

At this point, Mr. Chairman, I'd like to emphasize the importance of timely consideration of the IRS supplemental. As you know, we have submitted a $340 million supplemental request for FY 1986. The supplemental will:

- improve the quality of tax processing operations through more management oversight and employee training;
- increase service center staffing to stay current with the work load; and
- provide taxpayer service levels that are responsive to taxpayer requests for information and account status.

Mr. Chairman, I cannot overstate the importance of the supplemental funds to IRS operations both now and in the foreseeable future. In order to maintain current activity levels and allow for the logistical continuity of operations, prompt action on the full amount of the request is critical.

II. Our second objective is to strengthen the capability of the IRS to promote tax compliance and generate revenue.

In FY 1986, the supplemental request will enhance the following enforcement and revenue producing activities:

- hiring and training of audit staff in advance for a major drive to increase tax revenues in FY 1987 as part of a three-year revenue initiative;
- increased actions against abusive tax shelters and attention to currency transaction reports; and
- assistance to states in carrying out audits of foreign and domestic activities of multinational firms.

In FY 1987, we intend to build a stronger and more credible deterrent against noncompliance with tax laws. In FY 1985, IRS faced an estimated tax gap -- taxes owed but not paid -- of over $100 billion. This gap has risen from $29 billion in 1973, when the IRS first began estimating it. This continued erosion of our receipts base through noncompliance undermines the confidence of the general taxpayer and needlessly adds to the budget deficit.

The cornerstone of the request is the previously mentioned revenue initiative which will yield $10 billion by FY 1991. We are also seeking funds for other high-yielding activities. These include faster litigation of pending tax shelter cases to reduce case backlog and the resolution of unreported income cases disclosed through the document matching program.

III. Our third budget objective is to meet our law enforcement and protection responsibilities.

The FY 1987 budget for Customs provides for stabilization of the investment in drug interdiction and overall staffing levels at approximately the 1985 level. The requested funds will permit Customs to:

- enforce our Nation's import and export laws through the processing of over seven million entries of merchandise, 93 million carriers and nearly 300 million passengers;
- collect over $15 billion in revenue; and
- operate the recently acquired tools to combat drug trafficking.

The requested funding for the Secret Service will help us prepare for the 1988 Presidential campaign and protect foreign dignitaries visiting the 1987 Pan American Games. The Service will acquire sophisticated equipment to better support its protective efforts.

The Bureau of Alcohol, Tobacco, and Firearms' budget will continue efforts to ensure the collection of all alcohol and tobacco excise taxes and to reduce the criminal use of firearms and explosives. We estimate BATF revenue collections at approximately $10 billion in FY 1987.

In FY 1987 the Federal Law Enforcement Training Center will institute a new policy of funding only the direct costs of basic training. Participating organizations will assume responsibility for the respective costs of the students' travel, meals and lodging.

IV. The fourth budget objective is to supply the resources necessary to manage the Nation's finances and service the Nation's debt. This includes:

- continuing the Administration's efforts to improve cash and credit management; and
- putting into operation the "Treasury Direct" System for the issuance of marketable securities to individual investors.

V. Fifth, we must ensure adequate currency and coin to meet the Nation's demands. The requests for the U.S. Mint and the Bureau of Engraving and Printing will accomplish this objective.

VI. Sixth, we must provide for appropriate policy formulation and management oversight of Departmental operations. The Department develops and carries out the Nation's economic, financial and tax policies. In recognition of the Department's critical role in the Nation's economic affairs, the President has given the Department responsibility for chairing his Economic Policy Council.

As you are well aware, we are spearheading tax reform. The President believes that tax reform is of the highest priority; our tax system must be simpler, fairer and encourage economic growth. The Department is also advancing an initiative for sustained economic growth to help developing countries cope with their debt service problems.

Last fall, in conjunction with the other G-5 countries, we initiated actions to improve the U.S. trade deficit by bringing an overvalued dollar into better balance with their currencies. As a follow-on to those initiatives, the President has directed the Department to determine if a more comprehensive restructuring of international monetary relationships should be discussed with other nations.

VII. Finally, Treasury's budget continues the critical modernization efforts begun in previous years. We believe that investments in information systems pay off generously in increased efficiency over the long run. For example:

- For the IRS, requested funds will continue the Automated Examination System. The increased productivity from this initiative will enable IRS to collect additional net revenue of $5.1 billion through 1991.

- In the Customs Service, we need to move forward with development of the Automated Commercial System (ACS) and the Treasury Enforcement Communications System (TECS II). These systems will enhance productivity and effectiveness.
- In the fiscal services, we will continue to modernize the government's disbursement and collection systems, relying on electronic systems as opposed to inefficient and costly paper-based procedures.

In summary, our $6.0 billion request for the Department of the Treasury represents:

- a necessary investment in the IRS to preserve the integrity of the tax system;
- a prudent investment in the IRS to increase tax compliance and consequently make a major contribution to deficit reduction; and
- the responsible preservation of the essential governmental functions of the Department.

Mr. Chairman, that concludes my opening remarks. I shall be happy to answer any questions that you or the other Subcommittee members may have.

SBA TRANSFER

Secretary **Baker**. Thank you very much, Mr. Chairman. In the interest of time, since you have votes coming up and I have a meeting over with some other Senators shortly, maybe we ought to just dispense with the summary of my statement and you can insert it in the record if you will and go right to questions.

Senator **Abdnor**. We will do that. I have read it, and I have a hunch Senator DeConcini has too. So we will do that very thing.

First let me ask you about a proposal of the President, at least it's in the President's budget, to transfer a function of the Small Business Administration to the Treasury. Could you tell us how this will impact the Treasury operation.

Secretary **Baker**. Well, Mr. Chairman, the administration proposes to terminate SBA's credit activities to transfer its loan portfolio to the Treasury for liquidation and sale and to transfer the remaining operations of SBA to the Department of Commerce.

In order to fulfill our role and our functions in that regard, we are requesting an appropriation of $78 million and 1,664 positions for operations within the financial management service.

Senator **Abdnor**. Is that built into the budget now?

Secretary **Baker**. That is built into our request, yes, sir.

Senator **Abdnor**. I must confess I am probably not as well versed on this. Does this carry on the functions of the Small Business Administration, all their responsibilities are followed through? Is that——

Secretary **Baker**. It is to liquidate, Mr. Chairman, the direct loan portfolio, as I understand it, of SBA, and to supervise the gradual winding down and termination of the guaranteed loan portion of that portfolio.

Senator **Abdnor**. That will go on for awhile though?

Secretary **Baker**. Yes, sir, it will.

AUTOMATION FOR TREASURY

Senator **Abdnor**. Automation is the word at Treasury. And steps have been taken to upgrade the systems in the various bureaus. Money is being requested in this budget to further implement the upgrade. How far are we from having adequate automation to do a proper job? And what is it going to cost to get there?

Secretary **Baker**. Well, I'm not sure that we can with a fine tuned degree of accuracy predict a time when the Treasury Department would have adequate automation, Mr. Chairman. We have felt for a time, and felt rather strongly, that it is important to increase the effectiveness of our programs by converting various paper base systems in the department to electronic systems. And we have taken a number of steps and initiated a number of projects in that regard.

We have initiated a project to modernize the Government's disbursement and accounting systems through electronic funds transfer, a project to replace IRS service center computer equipment. We have implemented an automated collection system in IRS. And we are looking at automation of duty collection activities of the Customs Service.

EFFICIENCY AS A RESULT OF AUTOMATION

Senator ABDNOR. When you get it all in place, are there going to be savings or just more efficiency? Efficiency is savings, but will this help in dollar savings?

Secretary BAKER. Yes, sir; we think that there will be savings ultimately from automation.

Senator ABDNOR. I am sure we have plenty of places to put the manpower you use. The budget proposes to reduce the payment for the Financial Management Service to the Federal Reserve Bank for services. Legislation in the form of users fees is necessary for the Federal Reserve Bank to make up the difference.

I am concerned that legislation will not be enacted. What happens at this point? Do you have any problems? The budget does reduce the payments for the Financial Management Service.

Secretary BAKER. Well, if legislation which relates to the Bureau of the Public Debt is enacted, Mr. Chairman, the Federal Reserve can then withhold roughly $20 million as a payment to itself for the services performed. If there is no legislation, we will need an additional $20 million over and above what we requested.

But the fact of the matter is if we do not get it, the Federal Reserve will probably withhold the funds anyway to compensate itself. So I do not see that there is going to be major problems either way.

Senator ABDNOR. I guess we have to follow that more closely in this committee.

Senator DeConcini.

Senator DECONCINI. Mr. Chairman, thank you.

SPECIAL OCCUPATION TAX PROVISION

Mr. Secretary, a couple of specific questions. Last year the committee expressed its deep concern over the low level of compliance with the Federal special occupation tax provision under current law. Estimates are that the loss in revenue from liquor retailers who failed to pay this tax could be $25 million.

I understand that the administration has prepared legislation that would, in effect, put the burden of enforcing this tax law against the retailer on the backs of the alcohol wholesalers rather than the BATF. I would oppose putting the wholesaler in this untenable position of releasing their customers.

I would recommend for your consideration that the wholesalers be directed to provide Treasury with their most comprehensive list of retailers plus current, up-to-date information on any changes of address provided on a regular basis so that Treasury's data base of universe of retailers would be known on a computer tape. Then if coordination and cooperation with IRS could develop a tax-matching program, this would get you what I think would be a comprehensive data base with a mechanism to update that data on a regular basis.

Also you could piggyback on your existing computer capabilities the master list of those that are in compliance. Do you have any comment on how stringent you are on the proposal that you put forward? Or could this be considered some other way—not making them a law enforcement agency?

Secretary BAKER. I see no reason why it could not be considered, Senator. I will admit to you I am not familiar with the specifics of that legislative request. But I would be delighted——

Senator DECONCINI. Would you look at it please.

Secretary BAKER. Absolutely.

CUSTOM'S REDUCTIONS

Senator DECONCINI. My concern, and probably yours, is we talk about privatization. It is unfair to place the burden on the private sector if there is any other way to do it. And I suggest there is. It is no secret that my deep concern over the President's budget as it relates to the Customs Service, spells disaster for the agency to conduct an effective drug interdiction program.

When we asked the administration about this, whether it is your department or the Justice Department or OMB, particularly OMB, they cite to us that the overall dollar amount spent in drug enforcement is increased. That does not speak to the problems dealing with the Customs Service.

The President's proposed fiscal year 1986 rescission and President's fiscal 1987 budget will mean the loss of 1,547 positions at Customs and a 27-percent cut below 1986 appropriation levels for the air interdiction program.

There are conflicting stories floating around Washington about how aggressive you were in this. You and I talked prior to your confirmation and you left me with a distinct impression that certainly, up until this budget came out, you have been a strong force in support of the air interdiction program within Customs.

I would like to know if you or someone on your staff would walk us through what the process was with OMB. And quite frankly, Mr. Secretary, I want to know what you did, if anything personally, to try to keep these cuts from coming?

Secretary BAKER. Senator, let me first say that I do support the air program. And I think I ought to take this opportunity to point out that we are going to have operational in 1986 a number of capacities that we did not have in 1985. We have eight new, as you know, high endurance trackers, four P3–A surveillance aircraft. And we now have three aerostats.

That does not mean that we have achieved, nor can we in my view under these budget constraints expect to achieve, everything that some might desire for the air program. The reductions that you have referenced were to some extent, the result of Gramm-Rudman. To some extent they represent a rescission with respect to congressional add-ons.

And while it may not be all that some would like, I think it is fair to say, Senator, that the administration has determined that it ought to stabilize in these times of tight budget constraints its investment in this particular program while we determine what offers the highest return in the fight against drugs.

The Secretary of the Treasury is a member of the President's Drug Enforcement Policy Board. That Board is now meeting under the chairmanship of the Attorney General, and meeting regularly. We are having a debate, which I think is a very legitimate debate, about what offers the highest return. Is it intelligence gathering? Is it efforts abroad at the source of drugs? Is it work on the demand side? Is it enforcement within the United States? Or is it interdiction?

The fact of the matter is overall the President's budget allocates of the $1,800,000 devoted to the fight against drugs, 43 percent to interdiction. That $1.8 billion represents an increase of some $200 million over the dollar amount for last year.

So I think it is important to note that in these times of tight budget constraints we are not going to have everything we would like in a number of areas of the budget.

Let me answer the rest of your question, which really was what was my role. I was fully apprised of events respecting this program just as I was in other elements of the Department's budget. I was supportive of the actions of the principal budget players for the Department, that is the Deputy Secretary and the Assistant Secretary for Management, who is here with me today.

As a rule, I do not think it unusual for departmental operational issues to be delegated to the Deputy Secretary and Assistant Secretary for Management. I think, Senator, that we were very successful on behalf of the Department overall. We initially had a request of $6.1 billion, and ended up getting $6 billion overall for the Department of the Treasury.

I know that does not speak specifically to the air program. But with respect to Customs, for instance, I think we were also successful. The initial reductions that we were handed by OMB were significantly more onerous than the current level.

So I would like to answer your question by saying that I was as active as I think I should have been under the circumstances.

Senator DECONCINI. Mr. Secretary, first I think the record should show that the Congress, I believe, thinks that the chairman here and many in the House, on a bipartisan basis, made the decision that you and Mr. Meese and the others on that Committee are debating that the air interdiction is very important, and we have funded it when the administration has not asked. And it makes me wonder if it is not the psychology of the administration to say, well, we will not fund it because Congress will.

Let me just quote to you. Customs requested of your Department $189 million for the air interdiction program. You passed back $71.6 million. That does not seem to me to be a real hefty commitment to it just based on the paper. Now, OMB came back with $39.8 million. Then you were successful. Your Treasury appealed $75 million, you got $54.7 million finally. So you got some of it back.

I guess my question, Mr. Secretary, is—maybe it is unfair to ask a Secretary, but I had a strong feeling that you were really committed to this program, if you were willing to take it all the way, and I mean all the way to the Oval Office if necessary.

And with your strong position in this administration, I would just hope that you would consider taking that leadership role. Because I am sure the President is committed to drug interdiction. He said right before he met with President Dela of Madrid when he was in Mexico, and when he was in California, that drugs is No. 1. And I assume that does not include defense in that category—but No. 1 problem in this country.

Then we just got the figures for so many billion dollars increase overall drug enforcement, then the air program seems to get cut. And I do not mean to be lecturing you, Mr. Secretary, but I would sure like to see a forceful voice by you as Secretary of the Treasury right to the President if necessary to save this program.

Secretary BAKER. Well, Senator, if I may say so, I think the debate within the executive branch is legitimate. The Congress may have made its decision, but I think we are entitled to debate the issue.

Senator DECONCINI. Fair enough.

Secretary BAKER. And I do not think it is unreasonable if we are allocating ever increasing amounts to the overall border interdiction effort, which we are. Now, as much of it does not go to Customs air program as perhaps you and I would like to see. But the proper forum, if I may say so, for me to make the case initially at least, is within the confines of the Drug Enforcement Policy Board.

I think we had at issue between us at OMB something in the neighborhood with respect to this program of $20 million. And that is a lot of money. And I do not mean to suggest that it is not. But I spent 4 years in there as chairman of the Budget Review Board in the White House. And I just do not see appeals from Cabinet departments with respect to $20 million, to be very frank. Where the case should be made I think is in the Drug Enforcement Policy Board.

Senator DECONCINI. Thank you, Mr. Secretary. My statement I think stands for itself. And I appreciate your difference of view. I think $20 million is enough to go to the President. I think $1 million might be enough if it meant the difference between 60 percent of the cocaine that flies into this country. It is pretty hard to dispute that, now is the time to cut back on the air program.

GRAMM-RUDMAN-HOLLINGS REDUCTIONS

You mentioned Gramm-Rudman being a problem affecting this air interdiction program. Nobody can dispute that. But I notice in all but the Treasury accounts, the administration is requesting full restoration of the sequestered cuts mandated by Gramm-Rudman-Hollings. The total restoration for the Treasury would be $236.7 million. The only account that did not get restorations were Customs salary and expenses, Customs Air Program, and Federal Law Enforcement Training Center.

IRS argues in its justification that Gramm-Rudman was a one-shot deal. My staff called Senator Gramm's staff, and I am going to ask him myself. They were not so kind about it, they think there is a lot of games being played when this kind of request comes back. Your office accounts would have their full $3,299,000 Gramm-Rudman sequestered cut restored.

Why should any of the Treasury accounts have their Gramm-Rudman-Hollings cuts restored? After all Gramm-Rudman is a 5-year program to reduce the deficit. If you were to deny this restoration, what would happen? If we were to deny the restoration, what would happen?

Secretary BAKER. First of all, let me say that I did not mean to suggest that most of the reduction in the air program comes from Gramm-Rudman. I do not mean to make that assertion here. Because only $3.2 million is the Gramm-Rudman reduction and $19.3 million is a rescission for a total reduction of $22.5 million. I do not think we are seeking to restore the March 1 Gramm-Rudman, Senator.

As a matter of chronology the 1987 budget and the appropriation requests that are contained in that budget were completed prior to the final determination of the 1986 Gramm-Rudman-Hollings reductions.

Senator DECONCINI. Is your total restoration not $236.7 million?

Secretary BAKER. Yes, sir, I believe it is $236 million.

Senator DECONCINI. So is that not to restore money that was cut as of the sequester date of March 1? Maybe I am mistaken. It says restoration of Gramm-Rudman cuts.

Mr. ROGERS. Senator, I think it may be a matter of semantics here. We do not consider it to be a restoration of the cuts considering that the budget process in 1987 started with 1986 based on the 1986 base. So those numbers are built in in terms of 1987 calculations.

The numbers that are reduced for the appropriations that you cited, Customs, et cetera, have to do not only with Gramm-Rudman but also that other program rescissions.

You are right in terms of the Customs, the programmatic decision is not restored in 1987. That $30 million is not restored because also the administration's position is that is an elimination of the congressional add-on that was previously submitted in the 1986 budget.

Senator DECONCINI. What amount was the Gramm-Rudman cuts for Treasury 1986? Do you know the dollar amount roughly?

Mr. ROGERS. Gramm-Rudman reductions were $236.7 million.

Senator DECONCINI. OK. Now, I do not know what page it is here, but the executive summary at the start under revised fiscal year 1986 level, you list a whole number of things here, budget proposals. One of them says "restoration of Gramm-Rudman cuts made in 1986, $236.7 million." Now, there is no misunderstanding unless there is a typographical error in your justification here.

Mr. ROGERS. I think you are reading from the blues and whites.

Senator DECONCINI. That is right.

Mr. ROGERS. Which is actually a base adjustment.

Senator DECONCINI. That is my point. It is a base adjustment—you know—move it up and then start from there. I know you have got priorities. And I know a little bit about the executive branch, having served in one. And you have got to move these figures around.

But it seems to me when you are honest enough—and I compliment you for putting it in here—you say it is a restoration of Gramm-Rudman cuts. How are you saying it is not a restoration, you are not asking to put that money back in?

I do not think you are being totally up front with the committee quite frankly. Because you are totally up front here. And when I ask you about it, you say, no, it is different, it does not really mean that.

So it leaves me with a real problem, not to mention that I think it is unfair, to take the Gramm-Rudman cuts, restore them, and leave out what I think is very important—particularly the Customs program. I do not know what we can do about it. And I have not talked to the chairman about it. But I do not want to see your Department hurt.

But I think what is fair is fair. And we ought to follow either what you have here and make the decision of restoring Gramm-Rudman cuts. You say, no, we are not because the base is lifted up. Yet you have it right here that we are restoring Gramm-Rudman cuts.

Mr. ROGERS. I think what I meant to say is those restorations that are reflected in the 1987 that we have described in the blue and whites as actually being a restoration are previously approved programs. So to say that they are not a part of the base is wrong as well.

Now, to consider that you can take the entire thing that is part of Gramm-Rudman and that can be allocated between different accounts I think is equally unfair because those have to be considered each on their individual merit.

Senator DECONCINI. It seems to me like you have jacked up the base here by this——

Mr. ROGERS. No; I can assure you we have not jacked up the base. I think if you look at each individual account——

Senator DECONCINI. I am going to look at each one. And my staff tells me that they are there, that they are moved up on that basis. I cannot dispute that now. You say they are not. If I am wrong, I would be glad to admit it. It bothers me the way your budget is entered here. You may want to look at that.

Secretary BAKER. All right, sir.

Senator DECONCINI. Mr. Chairman, I have some other questions. I would be glad to yield to you.

Senator ABDNOR. I would like to follow up on the question of Customs. Several weeks ago Mr. Miller was in front of the Appropriations Committee, it was kind of an overview. I brought up the subject of the cuts in the Customs, and he pointed out that overall it was over something like $100 million being put into the drug fight through FBI and DEA.

You know, we keep talking about a cost-effective budget. And he feels the best way to fight drugs is once it gets into this country. I have a hard time believing that. I think it is a heck of a lot easier to put the fight at the border and stop the drugs from coming in than trying to dig it out through every peddler up and down the line in the country who is selling it to our kids and others. That bothers me. I do not know if Senator DeConcini heard that or not.

Senator DECONCINI. Sorry, Mr. Chairman.

Senator ABDNOR. I just said I think they had added a couple million dollars to FBI and DEA, and I am just arguing I think the border is a better place to stop the drugs than once it gets into the country.

Senator DECONCINI. I agree with you.

Senator ABDNOR. So this is called a cost-effective budget, and I really have problems with that. I just point that out. I am not saying you had anything to do with what happened over in the FBI and DEA, but with all due respect to the part they play in the fight on drugs, I think the fight is right there at the border.

Well, this is the sixth year I have been chairman of the subcommittee, and each year the administration has proposed to significantly reduce Customs personnel. This is not the first time. Each year the cry from the public is that Customs cannot process cargo or passengers quickly enough. I am off drugs for a moment, which is another one of their duties, processing cargo and the passengers.

While they are doing a fine job, there is no doubt improvements can be made in Customs. I want the record to note that I have supported management initiative, but I am tired of this we can do more for less syndrome.

And now I want to address the Customs automation proposal. I believe it will help but it is not going to be on line on October 1. And with this budget the people will be gone. Now, what is going to happen during the time before the automation comes on line?

Secretary BAKER. Well, Mr. Chairman, I do not believe that there is going to be a problem during the interim that we are seeking to get that automation proposal on line.

Senator ABDNOR. Will the people stay until the automation is operational? Is that what we are saying? I am referring to the gap.

We do not think your automation is going to take place exactly on October 1, and we suddenly layoff all these extra bodies. We have problems already, complaints. It is something that has got to be looked at.

Mr. ROGERS. Senator, phase one of the automated commercial system became operational in February 1984, and included the collection, entry processing, and automated broker interface modules. As of September 1985 the cargo release selectivity, a new bond subsystem, fines, penalties, and forfeiture modules were completed.

Senator ABDNOR. What else will be coming?

Mr. ROGERS. The 1987 request includes additional refinements for the automated commercial system.

Senator ABDNOR. That will not be ready to go?

Mr. ROGERS. That will continue throughout fiscal year 1987.

Senator ABDNOR. Our point is there are already problems, and there will be that many more during this interim period. We should look at it and have you tell us how you are going to solve that problem. I think we should have it on the record if we can, John.

Mr. ROGERS. Be happy to.

Senator ABDNOR. How you plan to handle that time in there.

[The information follows:]

Customs undertook to convert its traditional operating procedures to an automated commercial system [ACS], which applies the benefits of computer capabilities to Customs revenue and merchandise processing. After implementation of phase I in fiscal year 1984 and the subsequent improvements, the system is fully operational for many major functional tasks. It is already contributing to the substantial productivity growth experienced by Customs in cargo inspections and merchandise entry processing. ACS has assured the continued efficient operation of Customs commercial processing. By increasing productivity, it has enabled Customs to avoid adding positions which otherwise would have been required to achieve equivalent processing under the former manual system, given the increased workload Customs is experiencing.

As a result of an incremental implementation policy followed for ACS, there has been sufficient time for Customs management to carefully plan shifting displaced personnel to other critical enforcement functions without imposing a reduction in force. Incremental planning also has permitted a smooth transition even when a delay occurred in ACS operational implementation. As the ACS modules are implemented, staffing levels are adjusted to conform to other priority requirements. Thus a carefully controlled staffing balance is always maintained.

While the remaining ACS phases scheduled for development and implementation are refinements to the basic operational system, they are required to achieve a fully automated system. A most important innovation for achieving a paperless entry is the automated broker interface [ABI], which is scheduled to be fully implemented in fiscal year 1987. It will be a significant factor in increasing overall processing productivity. Currently, with the remaining ACS modules meeting implementation target deadlines, we do not foresee any delays in fiscal year 1987. However, should any delay occur, Customs will adjust staffing during the year, as it has done previously, to insure adequate personnel are onboard to handle all priority functions. The general contingency plan followed under these circumstances is to increase staffing during the emergency period and then reduce it as required later in the year. The plan conforms to authorized staffing and funding level.

USER FEES

Senator ABDNOR. Now, the budget proposes a number of user fees. I am not going to pass judgment on that at this time. I just put user fees on water projects, but I would say if a user is going to pay he should get the service he expects and deserves. And I do not think, frankly Mr. Secretary, the budget will provide that service.

Secretary BAKER. Mr. Chairman, he is getting some service now. We can argue over the scope and I guess extent of it. But the fact of the matter is he is getting service now. And the only way he is paying for it is through his taxes. And I guess in some ways that is the only way we would like him to pay for it.

But in the time of fiscal budget constraints we are going to have to figure out a way to pay for it. There is nothing being paid right now for what the Customs Service is.

Mr. ROGERS. I think you know the reconciliation bill calls for the user fee proposal of $200 million. And the administration's proposal is $545 million for recovery. The administration plan calls for crediting back to the general fund with a mark at least on the budget level.

Now, we are considering at the Department a proposal from Customs right now to look at some sort of crediting directly to the account in the commercial side.

Senator ABDNOR. Well, part of this is through that $5 a head on the passengers?

Mr. ROGERS. Right.

Senator ABDNOR. If this is delayed any more than it is now because of lack of manpower, and it does not work out, we are going to be awfully upset. I think if you give them good service, they will pay, and they may even pay a buck or two more if you move it. But having backlogs of people because of our manpower shortage is not good service. That is what we have been hearing and I do not think it is going to be much of a winner.

But we will just have to see what happens then.

IRS SUPPLEMENTAL

Let me ask you something else. Maybe I am over doing this, but the IRS is requesting a supplemental of $340 million for fiscal year 1986; is that not correct?

Secretary BAKER. That is right.

Senator ABDNOR. You know this committee initially provided funding that would cover some of this request. And yet in November the administration vetoed that bill and cited the IRS increase as one of the objections. This was done at the time the Treasury had already submitted a report to the OMB for a supplemental and added a bill for fiscal year 1987 base major increase for the IRS.

Now, in some way we are not communicating. What happened there?

Secretary BAKER. Mr. Chairman, the Department supported enactment of that appropriation bill at the time the administration was objecting to the total level of the bill compared to the congressional budget resolution and several language provisions in there affecting OPM and affecting——

Senator ABDNOR. I am sure we got the message somewhere.

Secretary BAKER. Plus there was an extra $289 million in the entire bill.

Senator ABDNOR. Nevertheless, this got picked on too and came out.

Secretary BAKER. All I am suggesting is that there were a number of problems with it. And our supplemental request to OMB, which is essentially equal to the present request, would have provided IRS with considerably more budget authority than was contained in the conference bill.

We now have OMB fully on board. And OMB is not only fully on board, they support the IRS supplemental, they have recently classified it as an urgent supplemental.

Senator ABDNOR. We do not look like the big spenders. We might have been on the part of OMB to a couple of charges. I will tell you this, they listed the IRS as part of it too.

Mr. ROGERS. Mr. Chairman, in the October 18 letter from the Deputy Director of OMB, he cited the IRS increases as being objectionable. I wrote the conferees on October 29 citing that OMB no longer had the opposition to that. And from that point on they changed their position. And the veto of the bill by the President did not specifically reference at all the IRS increase.

And in fact, once after it went to conference on the continuing resolution, Jim Miller wrote the conferees as well saying he supported enactment of the higher level for IRS. So we were successful at least in getting the objection out to IRS specifically.

Senator ABDNOR. Well, it is just being short minded on the part of somebody, OMB or someone in the beginning, to allow that to happen. It just makes us all look bad down here, at least for the moment.

Not that I am that touchy, but it is pretty obvious to us in Congress that reconciliation was calling for us to put on more manpower at IRS to raise more dollars to offset the finance and try to raise the million dollars. I think my majority leader was asking us to do it. And then it is vetoed.

They better think before they put those up. That is for OMB, not for you.

Senator DeConcini.

Senator DECONCINI. Mr. Chairman, I agree with your observations there in the Customs area. And I think the Secretary knows how you and I feel about it.

Mr. Secretary, if I could change gears on the tax proposal of Treasury II and the proposed Packwood bill and what have you, I realize this committee does not have jurisdiction over it, but I cannot help but ask you the question. The tax proposal by Packwood would treat different State and local taxation in a different manner, allowing the deductibility of State and local income and real property taxes but not allowing the deductibility of State and local sales taxes and personal property taxes.

Do you think that the Federal Government should treat different types of State taxing authority differently?

Secretary BAKER. Well, I think in the context of an overall overhaul, if you will, of the Tax Code, that it is not inappropriate to consider doing that, Senator DeConcini. I think that frankly—and I have said this from day one—I do not think you will get meaningful tax reform on the individual side unless you are willing to deal with the State and local tax deduction.

I realize that will to some degree tend to skew State preferences with respect to revenue sources. But there are other things that we do at the Federal level that skew State decisions with respect to revenue sources, excise taxes and the like. So I do not think that it is inappropriate to do that.

The Packwood markup document calls for the elimination of sales and personal property taxes as you point out. It preserves the real property tax deduction, but it does not necessarily preserve the income tax deduction. It in fact calls for the income tax deduction to take a hit because it is only——

Senator DeConcini. Let me just give an example of the State of Arizona. In 1982 Arizona received only 18.9 percent of its tax revenues from individual tax, and 38.7 percent from property taxes, while it received 42.4 percent from sales taxes. It just so happens that you will notice that the State of Oregon has the third highest reliance on income taxes. I understand where the chairman is coming from, and I would be doing the same thing.

What I am trying to suggest, Mr. Secretary, is that in your involvement in this effort, instead of pitting States against each other because one has a high income tax or no sales tax or low sales tax, couldn't a formula be worked out where you treat everyone equally—you get half of whatever it is or all of it. I agree with you that you are probably going to have to do something about those State tax deductions to get to your revenue.

But I hate to see us pick up high income States versus high sales tax States. I can see a war developing here that is not going to be very pleasing.

Secretary Baker. Senator, that is very well taken. And the approach that we originally suggested would have treated them all equally. And I think that is probably——

Senator DeConcini. See how far you got with that.

Secretary Baker. Then you do not skew State taxing decisions. The fact of the matter is my home State is likewise going to be affected where we do not have an income tax. So I do not argue with your conclusion at all. It may be that during the course of markup that someone will come forward and make that——

Senator DeConcini. Maybe in your meeting this afternoon and other subsequent meetings it can be raised as to the equity of it. That is what I am very concerned about.

Secretary Baker. It is a very difficult problem. And of course, I will say one more time, we approached it along the lines that you are suggesting originally.

Senator DeConcini. There has been a great deal of talk about tax amnesty, even cited some time as a cure-all for budget deficits and tax noncompliance. At the same time many experts will say that in the tax field, they raise serious questions about the money that this can raise and whether or not this is really different than the successful tax amnesties in the States.

I am just interested in what your observations are—personal opinions—on tax amnesty. Is it fair and can it be effective on a national level? I am not asking you to come out in support of it. I just want to know what you think.

Secretary BAKER. I think that the Federal situation is different, Senator, than perhaps in some States. We are now studying the question of Federal tax amnesty at the request of the President. We will be reporting back to him within a reasonable timeframe. But there is a difference.

For one thing, the compliance rate has been higher, generally speaking, at the Federal level. Any tax amnesty program, to be successful, must be accompanied by a strong compliance effort. And if we were to go down that road, we would have to look very, very seriously at additional compliance measures.

Furthermore, a Federal amnesty would be counterproductive unless we could make the case persuasively to the American people that this was a one-shot deal and we would not be coming back again with another amnesty in a few years the way some countries who have embraced tax amnesties have done. Because our system depends strongly on voluntary compliance. And we have been fortunate enough to have a reasonably high percentage of compliance throughout the history of this country.

Senator DECONCINI. Can you share with us any ballpark figures of revenues?

Secretary BAKER. We are still looking at that, Senator. But they are not as significant as some of the numbers that have been kicked around up here, no, sir.

Senator DECONCINI. You are talking about in the low billions instead of the double digit billions that we hear talk about here?

Secretary BAKER. Yes, sir, at the very least we are. And most of the revenue quite frankly comes from enhanced compliance that would follow an amnesty.

Senator DECONCINI. Year after year you mean.

Secretary BAKER. Yes, sir.

Senator DECONCINI. Thank you Mr. Secretary. I have no further questions.

Senator ABDNOR. I have a few. But just to finish up on amnesty, compliance is really the key to it. I mean you have to have better compliance if you are going to really make it.

Secretary BAKER. You do.

Senator DECONCINI. If I could, on that subject matter on compliance, if you will yield?

Senator ABDNOR. Yes.

Senator DECONCINI. You will have to have far more people and personnel in the program. That would be in addition to what IRS is asking for in the 1987 budget and supplemental. Is that what you are saying?

Secretary BAKER. Yes, sir, that is what I am saying. We have, as you know, an enhanced compliance program phasing in.

Senator DECONCINI. 5,900.

Secretary BAKER. 2,500 a year for 3 years beginning in fiscal 1987.

Senator DECONCINI. Thank you, Mr. Chairman.

Senator ABDNOR. One last—two questions. In fiscal year 1985, IRS experienced considerable difficulty in processing returns resulting in late refunds for many taxpayers. This may every year prove to be an even more difficult problem since the IRS estimates in fiscal year 1986 it will process over 5 million more returns than it did in fiscal year 1985.

Now, to prevent return processing backlog and to get refunds out in a timely manner, has Treasury studied the cost and the benefits of the Federal Government on a staggered filing season? If so what were the results?

Secretary BAKER. Well, we have taken a look at that, Mr. Chairman. And I think that there is no—well, let me say this: I have discussed it with the Commissioner myself. And the Commissioner has no objection to looking at it and considering going that route. He now has a study in progress. We will be completing that study next month.

The Service is working with GAO in connection with this study. And we will be sharing the results of that study with you just as soon as it is completed, which as I mentioned should be some time next month.

Senator ABDNOR. Conceivably——

Secretary BAKER. Let me say one final thing. The issue was looked at by IRS back in 1977. At that time they considered two options, moving the filing date back to June 30 and creating two filing seasons during the year. And they concluded at the time that they should not move to that process. But we are actively studying the issue right now.

Senator ABDNOR. How long ago was that?

Secretary BAKER. 1977.

Senator ABDNOR. Well, it could make the overall job of the IRS more effective this way, I mean by spreading the work load out not only in that area but other areas as well?

Secretary BAKER. It might. That of course is the argument. But then you have the question of finding ways to change the current behavioral patterns of taxpayers. I can remember, and I am sure you can, when I used to struggle with my own tax return before every April, every year I would get properly psyched up. I do not know if I can handle changing the date.

Senator ABDNOR. Last question. I am going to get parochial, I have not done that yet.

Senator DECONCINI. No offense, Mr. Chairman.

Senator ABDNOR. The Treasury Department has considered a satellite plan for the Bureau of Engraving and Printing. And I am going to be parochial here. I understand Sioux Falls, SD, which has been one of the applicants, has been dropped. I do not know if you have made a final decision, but I believe Sioux Falls could make a good place for the plant.

Therefore, I would like to ask you to take another look at Sioux Falls. I forgot what they tried to say was wrong—air transportation. You know, in one breath they tell you how well we are doing, and in the next breath with this great system we have one place where we do have good surface and it is Sioux Falls, SD.

We would just like to have the crumbs left over going to some other parts of my State. By golly, do not let someone tell you they have air service over there. Come out.

Secretary BAKER. Maybe it dropped down on the availability of armored carriers or vault storage facilities.

Senator ABDNOR. Will you take another look?

Mr. ROGERS. We will, Senator.

Secretary BAKER. Sure. We will be glad to, Mr. Chairman. And we have looked at more than 80 cites. It was a question of nonstop air transportation to the Federal Reserve district cities, that that was a criteria that Sioux Falls did not meet.

Mr. ROGERS. And the branch banks. Not only the district banks, but their branches as well.

Senator ABDNOR. Well, we will work on it.

ADDITIONAL COMMITTEE QUESTIONS

We have some questions that we are going to submit to you in writing if you do not mind. And we thank you very much for your attendance here.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

CONTRACTING SERVICES

Senator ABDNOR: The Internal Revenue Service recently lost a case before the Board of Contract Appeals with regard to the upgrade of computer services. I am concerned for several reasons. First, the cost; then, possible delays. Considering the fact the Department will have many automation contracts in future years, what is being done to insure problems like this are not encountered in the future?

Secretary BAKER: In the Sysorex case, a problem occurred in the evaluation of pricing proposals. The General Services Board of Contract Appeals (GSBCA) did not find fault with the procedures by which the price evaluations were to be conducted, but there were serious errors made. Price evaluations are complicated, involve a number of steps, and, up to this point, have been done manually. To ensure we do a better job, we are adding staff, including a cost/price analyst to provide expertise in conducting price analyses and reviews of price evaluations. In addition, the format for submitting pricing information has been developed to process the pricing data submitted.

The procurement process is complex. It is impossible to eliminate all errors on the part of the vendor community and/or the Government, but the steps we are taking to simplify, automate, and increase staff will minimize the potential.

SENATOR ABDNOR: Gramm-Rudman-Hollings has imposed reductions on the Department. It has cut quite deeply into some agencies where we have kept funding constant through the past few years. I am concerned about the impact of activities in the Treasury bureaus. I am asking each bureau to detail how they have applied the sequestration, but I would like your comments as to how it will impact the Department.

SECRETARY BAKER: The FY 1986 Gramm-Rudman-Hollings (G-R-H) sequestration amounts were determined after the Administration had made its decisions on the FY 1987 President's Budget, decisions designed to reach the G-R-H FY 1987 deficit target. It was therefore necessary to make the FY 1986 G-R-H reductions in ways that did the least damage to the ongoing programs proposed in the FY 1987 Budget.

In general, the Department's reductions were in administrative areas such as travel and training, equipment replacement, and, in some cases, replacement hiring. These are the types of reductions that can be done most easily in the short-term. To continue these for long periods seriously weakens the organization.

The President's Budget proposal for FY 1987 will meet the G-R-H deficit target. With the assistance of the of the Congress, a FY 1987 sequestration will not be necessary.

Senator Abdnor: I am very concerned about the numbers proposed for Customs. First, let me say that the rescissions of the Congressional initiatives bothers me. The service cannot hire to fill slots Congress provided because of cuts. Now you are also rescinding an additional $23 million. Could you tell us why the rescissions are being made?

Secretary Baker: The Federal deficit must be reduced: the Administration and the Congress both agree on that. The proposed rescissions of $4.2 million and $19.3 million for the FY 1986 Salaries and Expenses and Air Operations and Maintenance Appropriations, respectively, are included in support of the Administration's deficit reduction initiative.

The proposed rescissions for Customs were the result of some very difficult decisions. However, we believe that despite these reductions, a strong interdiction presence will be maintained at our land, sea, and air borders.

Questions Submitted by Senator Dennis DeConcini

MR. DECONCINI: Last week IRS came before this Subcommittee and confirmed that they had already hired many of the 6,950 new personnel that were requested in the agency's fiscal 1986 supplemental of $340 million. This hiring was done without any Congressional approval; without any hearings; without any supplemental appropriation approved by the Congress and the President; and was started months before OMB approved a deficiency apportionment. The bottom line is that if Congress does not appropriate the full $340 million, IRS will have to RIF those people that it had already hired without Congressional approval. I resented it then; I resent it now; and, if this Senator has anything to say about that supplemental, it will be denied.

How did you allow IRS to go ahead and hire new personnel without a Supplemental Appropriation in place; without OMB deficiency apportionment approval; or without any consultation with this Committee?

If this supplemental was so urgent, then why did it take until last week for the Administration to let Congress know that it should be moved as an "urgent" supplemental? After all, Congress has already passed two emergency supplementals and the President has signed one into law.

SECRETARY BAKER: An IRS supplemental request was submitted to the Department on August 28, 1985, for FY 1986 and included proposals to fund the Service at the level considered necessary for tax processing and tax enforcement. That request was submitted to the Office of Management and Budget in September 1985. It represented the results of a careful review of the funding necessary to restore the tax administration system to the level required to meet tax processing and enforcement responsibilities.

The Administration fully supports the amount and urgency of this supplemental as was indicated in Deputy Director Wright's letter to this Committee last week. OMB has apportioned these funds on a deficiency basis.

IRS has been spending at a rate which assumes enactment in order to ensure a smooth filing season. Basic tax return processing activities are at their peak during the January through June period. IRS believed it important to address backlogs that existed in critical tax processing areas resulting from FY 1985 problems and to prepare for this peak return processing period.

OMB delayed official approval of deficiency apportionment until after the implementation of Gramm-Rudman-Hollings reductions on March 1, 1986. However, they recognized the importance of the additional resources in the IRS and supported IRS steps to ensure that problems encountered in the 1985 tax filing season would not be repeated in 1986.

Senator DeConcini: Could you or your assistants walk us through the series of requests and appeals between Customs, Treasury, and OMB? In other words, what was Customs' original request for Salaries and Expenses for FY 1987; how much did Treasury cut them

back before sending the request to OMB; what did OMB send back on the first cut; etc.

Secretary Baker: I have outlined below the budget history for Customs FY 1987 Salaries and Expenses appropriation request.

FY 1987	Salaries and Expenses	
	FTE	$000
Departmental Submission	14,703	830,408
OMB Submission	13,835	753,466
OMB Passback Level	12,370	684,800
Customs Appeal Level	12,635	721,400
Congressional Submission	12,494	693,000

GREY MARKET

Senator DeConcini: Mr. Secretary, as you know, for the past several years I have been urging the Administration to take a stand with regard to the so-called Grey Market issue.

To avoid the wrath of industries on both sides of this issue, the Administration has been artfully dodging the grey market matter, despite court decisions that seem to indicate a change in policy in required by law. Our report accompanying the Treasury appropriations bill last year called on the Administration to publish and make available to us the results of a Cabinet Council analysis of the parallel imports issue. The report was due December 31st, but I understand we still are waiting for that report.

What is the status of that report and when can we expect to receive it? And has the Administration finally taken a position on how the grey market issue should be addressed? If not, why not?

Secretary Baker: The Economic Policy Council (EPC) has met on this issue and has decided to promulgate a notice in the Federal Register soliciting public comment on the merits of Federal regulations requiring demarking on labeling of grey market goods. After these comments are received and evaluated the EPC will decide which, if any, compromise it should adopt. The notice is currently in the process of being drafted. It will be published in the Federal Register as expeditiously as possible. A decision will not be made until this process is completed so it is difficult to say with any certainty just when a report will be issued. However, it must be stressed that we share your concerns about the importance of the grey market issue and will ensure that the process is as expeditious as possible.

FEDERAL FINANCING BANK ACTIVITIES

Senator DeConcini: What would be the effect on Federal Financing Bank Activities if we were to deny this appropriation in Fiscal Year 1987?

Secretary Baker: The Departmental Offices is requesting an increase of $2 million, 19 permanent positions and 19 average positions for the administrative costs of the Federal Financing Bank. Historically, the administrative costs for the Federal Financing Bank activities have been financed through reimbursable agreements between the Federal Financing Bank and the Departmental Offices' appropriation. In FY 1987, the Administration is seeking a direct appropriation in order to reflect more accurately the cost of Federal Financing Bank administrative activities and to provide the Congress and the Executive Branch with more oversight of these activities.

This does not involve a net increase in funding or staffing resources within the Federal Government. Rather, it simply changes the means of financing the administrative activities from a reimbursement to Departmental Offices to a direct appropriation within Departmental Offices. If the request for direct appropriation financing in Fiscal Year 1987 were denied by the Congress, the Federal Financing Bank activities would necessarily need to continue to be funded on a reimbursable basis as they have in past years. The Congress would need to include specific language for the continuation of the reimbursable arrangement in FY 1987, which would restore the 19 permanent reimbursable positions, 19 average reimbursable positions and $2 million reimbursable funding to Departmental Offices.

DEPARTMENTAL OFFICES' TRAVEL

Senator DeConcini: Why has the Departmental Offices' travel budget grown by nearly one-third in these times of cheap air travel and fewer Federal employees?.

Secretary Baker: The Departmental Offices has requested $1,296,000 for FY 1987. The request includes a modest increase of $53,000 over the FY 1986 appropriation to offset the impact of inflationary cost increases in the overseas travel area. It is currently projected that the cost of business travel will increase 10 percent this year. The travel budget includes hotel and per diem expenses as well as transportation expenses. It should be noted that this is the first such increase requested in several years.

With regard to the current airfare wars, Treasury employees, as well as all other civilian government employees, must fly contract airlines. These fares are negotiated by the General Services Administration with airlines every October and remain in effect for the entire year. Our employees cannot partake of the current decreasing airfare prices. Also, many of these "super deal" airfares have stringent restrictions such as 30 day advance bookings and limited city locations. Employee travel requirements, very often occuring with less than two week departure dates, cannot easily be accomodated within these stringent airfare guidelines; therefore, we are not generally able to take advantage of the savings.

In addition, there are several unique circumstances in the Departmental Offices travel budget which result in a fluctuating travel base requirement from year to year. The travel budget for Departmental Offices supports travel for the Secretary and other senior officials of the Departmental Offices in fulfilling their roles as policy advisors on both domestic and international activities of the Department. The Secretary and his staff are routinely expected to attend major international meetings as representatives of the United States Government. Many of these meetings rotate hosting countries so that in any given year many of the regular recurring meetings will all be held here in the United States. Conversely, the next year these same trips would be held overseas. This situation occurred between Fiscal Year 1985 and Fiscal Year 1987. In our budget requests to the Congress, we plan for these extraordinary requirements in future budget years as we have done here. We remain scrupulous in the use of travel funds for all of our meetings.

VOICE PRIVACY FOR ALL TREASURY LAW ENFORCEMENT AGENCIES

The Department of the Treasury is moving ahead to ensure the privacy of its voice communications. Within the bureaus, several specific programs are now underway to provide voice privacy:

o All Bureau of Alcohol Tobacco and Firearms (ATF) mobile handheld radios supporting law enforcement operations are encrypted. By 1987, all mobile car radios will also be equipped with Data Encryption Standard (DES) voice radios.

o In 1985, U.S. Customs Service completed installation of secure voice radio equipment in all drug operations aircraft. These radios are compatible with Department of Defense equipment as appropriate.

o Within the U.S. Secret Service, the Presidential and Vice Presidential protection divisions presently use voice privacy systems. Equipment is also being provided in various other support units. The Chief of Communications has been detailed to a special project addressing the entire voice privacy issue.

The overall interoperability question is a difficult one and requires major systems re-engineering, long range planning, and reallocation of frequencies. Treasury is now exploring an approach to accomplish the necessary planning and engineering to achieve this goal. ATF does have the capability to interoperate with other law enforcement agencies (including State and local organizations) through the use of programmable frequency radios. Also, the Secret Service's systems are compatible with those of the White House Communications Agency (WHCA).

By 1987, all Federal, as well as State and local, law enforcement agencies will achieve some degree of secure telephone interoperability through implementation of the future low cost secure telephone units, the STU-IIIs, which include a cellular version.

In recognition of the need to protect all Departmental sensitive information, to include law enforcement information, the Department also issued Treasury Directive 81-40, "Information Systems Security," on April 2, 1985 (attachment 1). This directive requires all sensitive, as well as classified, information to be secured when stored, processed, or communicated by Treasury information systems.

Finally, the Department is developing a Treasury directive on protection of law enforcement information systems. This policy specifies the minimum level of security/protection to be afforded Treasury classified and sensitive law enforcement radio and other type systems. The policy requires all bureaus to implement voice privacy on their law enforcement radio systems. The directive also requires that Treasury organizations specify interoperable secure communications in order to conduct joint operations with other law enforcement agencies. These include the Drug Enforcement Administration, the Federal Bureau of Investigations, and State and local law enforcement systems.

A chart indicating 1987 funding for secure voice communications for Treasury law enforcement agencies is included as attachment 2.

Attachment 1

Department of the Treasury	Directives Manual	Chapter TD 81	Section 40
			Date: 4-2-85

SUBJECT

Information Systems Security

1. PURPOSE. This directive defines the categories of information which require protection from unauthorized access or disclosure; directs that the information be secured when stored, processed, or communicated by Treasury information systems; and assigns system security responsibilities within the Department of the Treasury.

2. SCOPE. This directive applies to the Office of the Secretary and all bureaus.

3. REFERENCES.

a. Title 31 U.S.C., Section 321 (b) (Money and Finance).

b. National Security Decision Directive 145, Telecommunications and Automated Information Systems Security, dated September 17, 1984.

c. Executive Order (E.O.) 12356, National Security Information, dated April 2, 1982.

d. National Communications Security Directive, dated June 20, 1979.

e. Treasury Department Order 114-1, Establishment of the Office of the Assistant Secretary (Electronic Systems and Information Technology).

f. TD 71-05.A, Safeguarding Officially Limited Information, dated September 11, 1981.

g. TD 71-21.A, Administration of Security Violations, dated February 26, 1982.

h. FIPS PUB 73, Guidelines for Security of Computer Applications, dated June 30, 1980.

i. 31 CFR Part 2, National Security Information, dated December 23, 1982.

j. Information Security Oversight Office Directive No. 1, dated June 23, 1982.

k. Transmittal Memorandum No. 1, dated July 27, 1978, "Security of Federal Automated Information Systems", to OMB Circular No. A-71.

l. Treasury Personnel Management Manual Chapter 732, Subchapter II (Sensitive Positions), Paragraph 6 (Automated Data Process Guidelines).

m. Title 31 CFR, Sections 9.735-44, 0.735-47 and 0.735-55(i) (Minimum Standards of Conduct).

4. BACKGROUND.

a. Systems security is a major concern because of the current technology explosion and the shift within the U. S. from paper-based information to electronic information systems. Treasury information systems are vulnerable to exploitation. Assuring the security of information systems which process, store and communicate classified national security information and sensitive information is a national responsibility.

b. As depicted in Attachment 1, information systems within the Department comprise telephone, teletype, data, facsimile, radio, computer, access authentication and video systems. Transmission media used by the Department include landline, cable, radio, microwave, satellite and fiber optics. The illustration also depicts the typical security measures that are applied to a system which processes and communicates national security or sensitive information.

c. Departmental policy, standards and guidelines for information systems security to include communications security, computer security, physical security, unintentional emissions security, access authentication, key management, and personnel security shall be developed and promulgated throughout the Department. To ensure the security of a system, all of these measures must be appropriately applied. System security is only as strong as its weakest link.

5. DEFINITIONS

a. Information Systems are electronic equipment, systems, or methods used to generate, store, process, transfer or communicate information.

b. Information Systems Security includes all measures designed to deny access to systems or information contained therein, by those without proper authorization.

c. Communications Security (COMSEC) includes all measures taken to deny unauthorized persons access to information derived from telecommunications, and to ensure the authenticity of such communications.

d. Encrypt means to convert plain text into unintelligible form by means of a cryptosystem. NOTE: The term encrypt encompasses the terms "encipher" and "encode".

e. Decrypt means to convert encrypted text into its equivalent plain text by means of a cryptosystem. NOTE: The term decrypt encompasses the terms "decipher" and "decode."

f. Computer Security (COMPUSEC) includes all measures designed to prevent deliberate, negligent or inadvertent unauthorized disclosure, acquisition, manipulation, modification or loss of information contained in a computer system, as well as measures designed to prevent denial of authorized use to the system.

g. Physical Security includes all physical measures necessary to safeguard information, equipment, materials, and facilities from unauthorized access or observation by unauthorized persons, or from natural hazards from within or without information system facilities.

h. Key is a sequence of symbols or their electrical or mechanical equivalents which, in machine or auto-manual cryptosystems, is combined with plain text to produce cipher text. (Often used informally as a synonym for keying material or cryptovariables.)

i. Key Management involves selecting keying material format, forecasting quantitative requirements for keying material, authorizing production and classification of keying material, determining keying material lead times and distribution, providing for proper destruction, and implementing contingency keying material. A Key Management Plan is concerned with system security, physical security, personnel security, interoperability, manageability, and user friendliness.

j. Emissions Security (TEMPEST) includes all measures taken to deny unauthorized access to information of value which might be derived from intercept and analysis of compromising emanations from telecommunications, information processing, and cryptographic equipment.

k. Access Authentication includes all protective measures applied to verify an originator who transmits, relays, receives, or processes electronic information, the access to which must be controlled. Examples of systems requiring access authentication procedures are those handling electronic funds transfer (EFT) and law enforcement information. Access authentication techniques include terminal entry verification, electronic fingerprinting, or a similar type of personal identification which would assure that the user is authorized to access the system.

l. Personnel Security involves making a determination of an applicant's or an employee's loyalty and trustworthiness by ensuring that personnel investigations are completed in sufficient scope, commensurate with position sensitivity designations and according to the degree and level of access to classified and sensitive information. Included in the Federal Security Program are granting security clearances for access to classified information and personnel screening of those assigned to ADP systems.

6. POLICY.

a. Information processed, stored, or communicated by information systems will be placed in three basic categories: national security, sensitive, and public information.

(1) National Security Information. This category as defined is information pertaining to the national defense or foreign relations of the United States. Such information may not be classified unless its disclosure reasonably could be expected to cause damage to the national security. The terms "Top Secret," "Secret," and "Confidential" are the only terms to be used to identify classified information. Unauthorized disclosure of:

(a) Top Secret information reasonably could be expected to cause exceptionally grave damage to the national security,

(b) Secret information reasonably could be expected to cause serious damage to the national security; and

(c) Confidential information reasonably could be expected to cause damage to the national security.

(2) Sensitive Information. This category of information includes delicate, sensitive, regulatory, financial, law enforcement, privacy, life and mission critical, and proprietary information as well as Officially Limited Information as defined by TD 71.05.A. Willful or negligent disclosure or illegal or unauthorized manipulation of sensitive information would cause damage, to include:

(a) Loss of life or personal injury to any United States person or to any person under the jurisdiction of the United States;

(b) Loss of property through fraud, theft, or other unlawful means;

(c) Loss of privacy of an individual, resulting in the violation of personal (including corporate) privacy, property, and civil rights;

(d) Obstruction or impairment of official enforcement or regulatory functions;

(e) An individual, corporation, or any other type of commercial business structure to gain an unfair advantage in the competitive marketplace; or

(f) Damage to a person or any type of commercial business structure that has entrusted its proprietary information to the U. S. Government. Nothing in this subparagraph shall be construed to prohibit the disclosure of information when such disclosure is required by law or is requested or authorized by the legal owner of the information.

(3) Public Information. This category of information may be disclosed to the public without restriction but requires protection against erroneous manipulation or alteration.

b. All Treasury information systems generating, storing, processing, transferring or communicating classified national security or sensitive information in electrical form shall be secured by the proper applications of computer security, physical security, emissions security, and communications security techniques. All personnel who require access to information classified under an Executive Order on a "need-to-know" basis must be granted security clearances appropriate to the level of access required. Those who are required to access proprietary or other sensitive, nonclassified data, must have been appointed and processed under current Federal and Treasury personnel and personnel security directives according to the sensitivity designations of each position.

7. PENALTIES FOR UNAUTHORIZED DISCLOSURE OF INFORMATION.

a. Federal employees are subject to appropriate penalties if they knowingly, willfully, or negligently disclose to unauthorized persons properly classified or sensitive information. Penalties may include but are not limited to a letter of warning, a letter of reprimand, suspension without pay, dismissal, termination of classification authority, loss or denial of access to classified or sensitive information, or other penalties in accordance with applicable law and Departmental rules and regulations which can include criminal or civil penalties. Each case will be handled on an individual basis with a full review of all the pertinent facts. The severity of the security violation or the pattern of violation will determine the action taken. (See reference g for guidance.)

b. Non-federal personnel who knowingly, willfully, or negligently disclose to unauthorized persons properly classified or sensitive information will be subject to appropriate laws and sanctions.

c. Legal Authorities:

(1) 5 U.S.C. S 552a, the Privacy Act of 1975;
(2) 18 U.S.C. s 1905, the Trade Secrets Act;
(3) Internal Revenue Code, 26 U.S.C. s 7213 and s 7431;
(4) Chapter 35 of Title 44, U.S.C. s 3510;
(5) Executive Order 12356, National Security Information;
(6) 18 U.S.C. s 641, 793, 794, 798 and 952;
(7) 50 U.S.C. s 783; and
(8) Executive Order 10865, and
(9) P.L. 98-473.

8. RESPONSIBILITIES.

a. The Assistant Secretary (Electronic Systems and Information Technology) shall:

(1) Develop and prescribe policy, standards and guidelines for information systems security.

(2) After consultation with the appropriate office systems manager, prescribe or approve all equipment or techniques for the security of information systems within the Department. These security measures include the use of all cryptographic systems and equipment, COMPUSEC standards, access authentication techniques, TEMPEST application techniques, and the physical security protection of the information in the system and the system itself, to ensure the integrity of the Department's information systems.

(3) In coordination with the Inspector General, insure that all national systems security policies are implemented within the Department.

b. The Office of the Secretary and the Heads of Bureaus shall:

(1) Insure that all systems that store, process, or communicate classified national security or sensitive information are properly secured.

(2) Insure that all new information systems that store, process, or communicate classified national security or sensitive information have security features incorporated during the conceptual design phase.

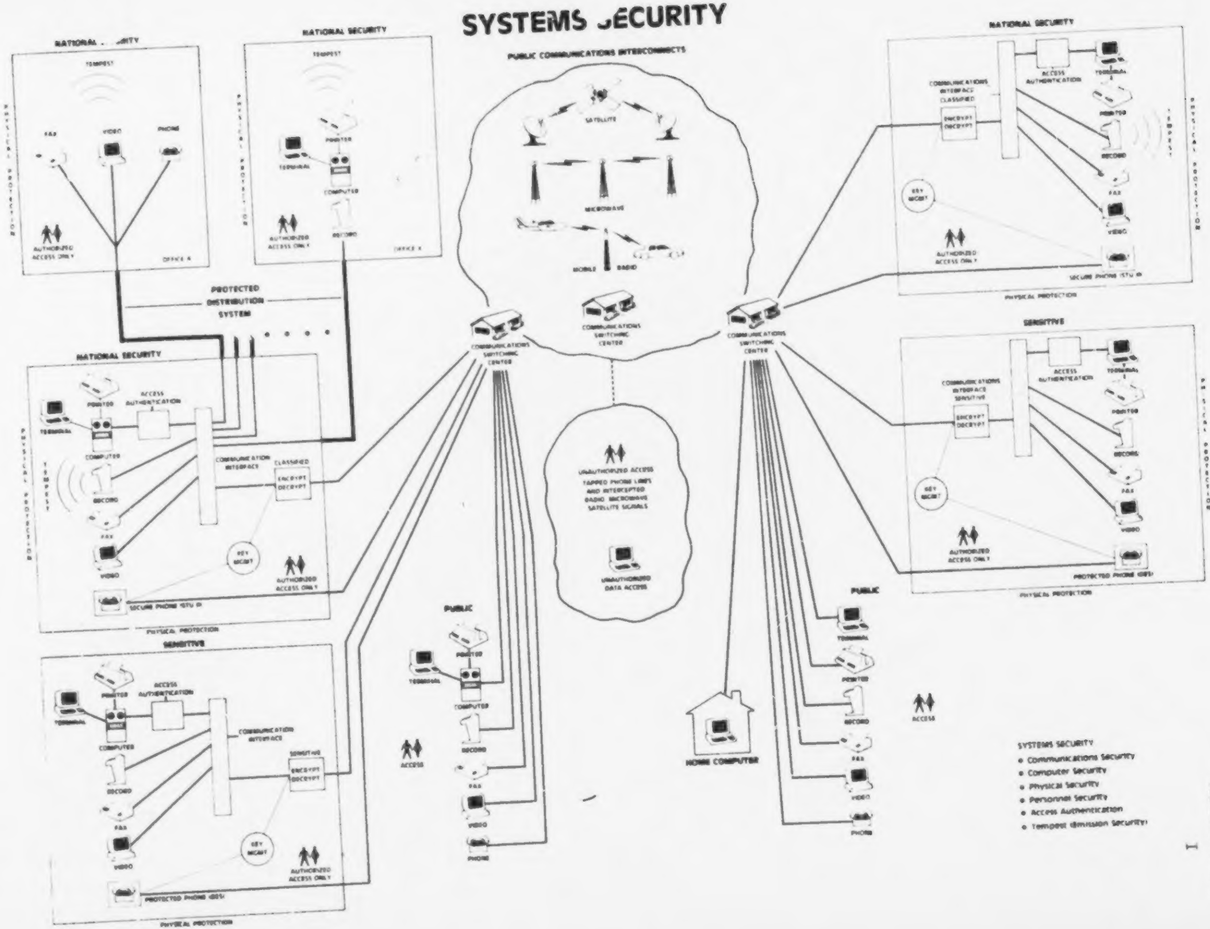
c. The Treasury Inspector General shall perform yearly audits of all Departmental information systems to insure provisions of this directive are accomplished and provide a consolidated report to ESIT.

d. The Physical Security and Safety Division, Office of Administrative Programs, is responsible for the physical security protection of the information prior to its entry into and outside of the system after it has been received.

9. OFFICE OF PRIMARY INTEREST. Office of the Assistant Secretary (Electronic Systems and Information Technology).

Robert E Conley

Robert E. Conley
Deputy Assistant Secretary
(Advanced Technology and Analysis)


SYSTEMS SECURITY
PUBLIC COMMUNICATIONS INTERCONNECTS
SATELLITE
MICROWAVE
MOBILE RADIO
COMMUNICATIONS SWITCHING CENTER
COMMUNICATIONS SWITCHING CENTER
COMMUNICATIONS SWITCHING CENTER
UNAUTHORIZED ACCESS
TAPPED PHONE LINES AND INTERCEPTED RADIO MICROWAVE SATELLITE SIGNALS
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TEMPEST
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KEY MGMT
AUTHORIZED ACCESS ONLY
PROTECTED PHONE (DES)
PHYSICAL PROTECTION
SYSTEMS SECURITY
• Communications Security
• Computer Security
• Physical Security
• Personnel Security
• Access Authentication
• Tempest (Emission Security)

ATTACHMENT
I

Attachment 2

Costs for Treasury
Law Enforcement
Security Equipment
Radio/Telephone
(Equipment only)

Fiscal 1987

	Data Encryption Standard (DES) Equipment (Radio)	Future Secure Voice System - Low Cost Terminal (STU-III) (Telephone)
ATF	$ 2.6 million	None
IRS	$ 4.3 million	$ 25,000
USCS	None	$ 150,000
USSS	$ 7.8 million*	$ 175,000

* This figure includes all radio equipment (DES and non-DES) budgeted in FY 1987 to support the Candidate Nominee Program.

SPECIAL OCCUPATIONAL TAX COMPLIANCE: BATF

Question: Mr. Secretary, last year, the Committee expressed its deep concern over the low level of compliance with the Federal special occupational tax provisions under current law. Estimates are that the loss in revenue from liquor retailers who fail to pay this tax could be as high as $25 million. I understand that the Administration has prepared legislation that would, in effect, put the burden of enforcing this tax law against the retailers on the backs of the alcohol wholesalers -- rather than on BATF. I would oppose putting the wholesalers in this untenable position of policing their customers and would recommend a different approach.

I would recommend that the wholesalers be directed to provide Treasury with their most comprehensive list of retailers plus current, up-to-date information on any changes of address provided on a regular basis so that Treasury's data base of the universe of retailers would be known and on computer tape. Then in coordination and cooperation with IRS, BATF could develop a computer tax matching program to keep track of retailer compliance. This would get you what you want -- a comprehensive data base with the mechanism to update that data on a regular basis, without Treasury paying to get that data. Also, you could piggyback on your existing computer capability to "crosswalk" the master list to those not in compliance.

Why wouldn't this be a more effective way to go after the compliance problem you are having with the Special Occupational taxpayers?

Answer: At first glance, the proposal seems to have merit. It appears that it should be possible to easily match by computer the data provided by wholesalers with the special tax data already on file in IRS. It soon becomes evident, however, that the tremendously high number of special taxpayers and records generated, and other factors, make the proposal unwieldly.

The latest statistics show that there are:

- 600,000 to 700,000 retail dealers - 260,000 to 300,000 retail liquor dealers and 330,000 to 400,000 retail dealers in beer and/or wine;
- 12,000 wholesale liquor dealers and wholesale dealers in beer; and
- 4,700 importers, 109 breweries and 1,300 wineries.
- It is estimated that each retailer is serviced on an average by 10 to 15 different suppliers.

Under this proposal, each supplier would provide ATF with a listing of all of its accounts plus periodic updates.

Because of the large number of retailers, and the duplication caused by suppliers serving the same retailers, this results in a very high number of staff-years being spent just processing the data.

Using the ranges cited, a minimum calculation would show: Approximately 6,000,000 records would have to be processed. Just to process the data would require a minimum number of 29 staffyears.

A maximum calculation would show: Approximately 10,500,000 records would have to be processed. Just to process the data would require a maximum number of 50 staffyears.

Other major problems with this proposal are:

The format that would be used by the wholesalers to give the lists of retailers to ATF. This could range from hand or type written lists to computer tapes, and all methods in between, with little or no compatibility among them.

The fact that IRS requires the Federal Employer ID number be furnished in order to make a computer comparison against its master file of special taxpayers. Wholesalers would not normally know a retailers' ID number nor can they require a retailer to furnish it.

There are other alternatives to this proposal that we feel would be more efficient and effective. They are:

1. Prohibit the wholesaler from selling to any retailer that cannot provide proof of having paid the special tax. This would ensure virtually 100 percent compliance with very little cost to the Government. However, we realize that this could be a burden on the wholesalers so we proposed the alternative of;

2. Have the wholesaler furnish ATF the names and addresses of any retailer they sell to that cannot provide proof of having paid the special tax.

The second alternative is that each supplier provide ATF with a listing of only those accounts that could not provide evidence of payment for a current special tax stamp. Under this approach, the total number of staff-years to process the data decreases dramatically.

> The minimum number would be 10 staffyears as the total number of records processed would drop from 6,000,000 to 2,100,000.
>
> The maximum number would be 20 staffyears as the total maximum number of records processed would decrease from 10,500,000 to 4,200,000.
>
> Also, as the delinquency rate was reduced, subsequent years' staffyear requirements for this processing phase would also be reduced.

The Bureau has not been insensitive to the burdens placed upon wholesalers by the proposed special occupational tax legislation. Initially, the proposed legislation would have prohibited wholesalers from selling to retailers who did not have a special tax stamp. ATF then modified its position so that the proposed legislation only requires wholesalers to notify ATF of retailers who do not have the stamp. The Bureau believes that this approach would be the most effective and efficient for all parties concerned.

Senator DeConcini: Mr. Secretary, one of the best kept secrets in this town is that the Customs Service is the second largest revenue producing agency we have, next to I.R.S. Yet the Administration continues to cut Customs personnel every single year.

Since fiscal year 1981, Customs has brought at least $54.7 billion into the Federal Treasury, not including interest and penalties assessments for noncompliance. In the current fiscal year alone, Customs will bring $13.9 and $15 billion into the Treasury -- more than twenty Customs' budget for fiscal year 1986. I.R.S. boasts that it has developed a computer model that shows a ten-to-one pay back for every dollar spent on tax enforcement. Yet, I have not seen any similar model for assess Customs. We have asked Customs to develop a similar model to the revenue producing productivity of its personnel . Could you help with this effort by directing that such a model be developed in time for your Fall FY 1988 budget submission to OMB?

Secretary Baker: Customs has attempted to adopt the methodology used by I.R.S. to assess the revenue producing productivity of its own personnel; however, our test program in the port of Philadelphia was halted by a court injunction. Subsequently, Customs has tried various other methods, but they have not produced statistically valid results. Customs has found that, on the whole, the sample size required to develop valid results would be costly in resources and produce delays which would exceed the benefits. Given the difficulties Customs has experienced in this effort, it is unlikely that a data base for a Customs revenue model could be developed for the fall FY 1988 OMB budget submission.

Question: The Currency and Foreign Transactions Reporting Act (Bank Secrecy Act) is a major tool in IRS Money Laundering investigations. However, as we understand it, only a financial institution can violate this Act by not filing a Currency Transaction Report (CTR) when required. Thus, the money launderer who successfully or unsuccessfully structures his/her transactions to avoid the filing of a CTR does not violate this Act.

Several bills such as H. 2785, H. 2786, and S. 1335, have recently been introduced in Congress to address the money laundering problem. While these bills would make money laundering a specific crime under Title 18, each bill contains certain provisions which would address the money laundering problem somewhat differently. Could you comment on these bills?

Answer: As the Committee recognizes, a person could launder the proceeds of an illicit enterprise without running the risk of liability under the Bank Secrecy Act as long as the required Currency Transaction Reports were completed. What is needed is a substantive criminal offense of money laundering such as the one contained in S. 1335, which was prepared jointly by Justice and Treasury. Such a measure was among the recommendations of the President's Commission on Organized Crime in its October 1984 report on money laundering.

There are several other money laundering bills before Congress that propose a criminal offense of money laundering and amendments to the Bank Secrecy Act that would enhance Treasury's enforcement of the Act. These bills have much to commend them, but the Administration's bill, S. 1335, presents the most comprehensive and effective approach. In addition to creating a criminal offense for money laundering, S. 1335 provides, among other measures, long-needed changes in the Right to Financial Privacy Act and civil summons authority to enable the Treasury Department to enforce the Bank Secrecy Act more effectively. It also improves the penalty structure of the current Act. None of the other bills contains all of these necessary measures.

With regard to structuring transactions to avoid the filing of CTR's, Treasury has presented to Congressman Pickle, in response to his request, a bill that would specifically address this problem. It is also being presented to all the committees considering S. 1335. The bill would penalize those who willfully structure transactions to avoid the $10,000 reporting requirement.

Even with favorable action on the anti-structuring amendment, the Bank Secrecy Act in and of itself is not sufficient to put an end to the pervasive problem of money laundering. As the Committee recognizes, a person could launder the proceeds of an illicit enterprise without running the risk of liability under the Bank Secrecy Act as long as the required Currency Transaction Reports were completed, and under the proposed amendment, as long as there were no structuring to avoid the filing requirements.

Question: What impact would they have on the person whose criminal proceeds are being laundered?

Answer: The bills that make money laundering itself an offense would help law enforcement close off the means by which organized crime launders its proceeds. However, the Administration's bill, by strengthening the Bank Secrecy Act as well, would improve our government's ability to use the reporting information to uncover the criminal conspirators who rely on money launderers and other underworld financiers. This bill also provides forfeiture provisions for the assets involved in a money laundering offense. Taken together, these measures will substantially strengthen our government's attack against the illicit organizations that traffic in drugs and engage in other forms of organized crime.

Question: What impact would they have on the persons who are paid to launder the funds?

Answer: These individuals are specifically targeted by the Administration's bill, which would prohibit financial transactions engaged in with the intent to promote any unlawful activity and transactions engaged in with knowledge or reckless disregard of the fact that funds are derived from unlawful activity. This approach differs from other proposed money laundering offenses in that it would reach more than transactions through financial institutions -- it would cover transactions through other businessess as well. For instance, if a narcotics dealer purchased a boat or an airplane, the boat dealer or airplane dealer would be liable if he or she knew or acted in reckless disregard of the fact that the funds were proceeds of an unlawful activity.

The effect will be to make it more difficult for criminals to enjoy the fruits of crime and more difficult for them to reinvest the funds in the criminal enterprise. A person paid to launder funds, whether a smurf or a financial institution, would be also liable if the requisite intent could be shown.

Question: Do these bills provide CID with the means to obtain evidence that monetary instruments are being laundered?

Answer: The Administration's bill, like a bill introduced by Senator D'Amato, would provide summons authority that would assist in the enforcement of the Bank Secrecy Act and also help the Treasury to discover evidence that could be an indication of money laundering. This provision is critically needed to provide Treasury and its enforcement bureaus the means to uncover instances of non-compliance by financial institutions, particular non-bank financial institutions such as foreign currency dealers and casinos, and to assist in the assessment of civil penalties.

Question: Would the Federal Government's burden of proof be excessive?

Answer: The arrangement of criminal and civil penalties, as well as forfeiture provisions, that S.1335 provides would enable the government to deal effectively with the serious problem of money laundering, and I am not aware of any problems that would arise regarding the burden of proof. However, I would defer to the Department of Justice regarding issues involving prosecutions under the bill.

Question: How would CID propose to alter any of these pending bills to provide IRS with the authority needed to effectively address the money laundering problem?

Answer: The Criminal Investigations Division, IRS, favors the approach in the Administration's bill as the best overall legislative response to the problem of money laundering. The legislative package submitted to Congressman Pickle is not intended as a substitute for this comprehensive approach, but it does contain, in addition to a provision on structuring, Title 31 (Bank Secrecy Act) forfeiture authority for currency related to a domestic reporting violation or interest in property traceable to that currency. This authority, in and of itself, would enhance the ability of the IRS to combat money laundering.

SENATOR DeCONCINI: What can we reasonably expect in terms of increased revenues to the Treasury from a tax amnesty program? Would you break those figures down into first-year gains and ensuing year gains from increased compliance.

SECRETARY BAKER: The Treasury Department continues to study all issues raised by an amnesty, including anticipated revenue gains in the year of program implementation and the years thereafter. We are not in a position at this time to provide a detailed revenue estimate. However, it is apparent that we could not expect an increase in revenues of the order of magnitude suggested by some in recent months.

SENATOR DeCONCINI: To make tax amnesty work, the American people have to believe that tax enforcement will be stepped up and made more rigorous. What kind of costs are we talking about to step up enforcement to that level? When you consider the increased costs of enforcement, what is the real gain to the Treasury under a tax amnesty program?

SENATOR BAKER: Irrespective of amnesty, tougher compliance measures should be adopted to improve enforcement of our tax laws. Additional revenue agents should be hired to ensure that taxes owed are paid. Such provisions designed to improve compliance could generate significant net revenues, and indeed account for most of the revenue gains we would expect from adoption of one of the pending compliance proposals including amnesty as a feature.

QUESTIONS SUBMITTED BY SENATOR MACK MATTINGLY

Senator Mattingly: I am pleased to see in your written testimony that one of your budget objectives is the continuing fight against drug trafficking. As you know, I have always been supportive of all efforts to combat this menace, and look forward to continuing to work to solve this problem. Do you feel this Fiscal Year 1987 budget request will allow you to successfully continue these efforts?

Secretary Baker: Customs FY 1987 budget submission does not permit us to do everything we might wish to do, however, our current situation is similar to many other agencies. In the face of large federal deficits everyone must do their share and Customs is willing to do theirs.

The FY 1987 proposed budget level for Customs required some hard choices, but we firmly believe that our proposals will permit us to retain a strong interdiction effort at our land, sea, and air borders.

SENATOR MATTINGLY: As you know, there has been a good deal of discussion recently concerning a "federal tax amnesty" program. I am personally against such a program, for I feel it will have disastrous long-term effects. You mentioned in your testimony that at the top of the list of major objectives of the Treasury Department is protecting the integrity of the tax administration system. Could you please tell me what impact, in your view, such a program would have on this objective, and also could you please tell me what the Administration's position is on this proposal?

SECRETARY BAKER: A major objective of the Treasury Department is to protect the integrity of the tax administration system. We are studying all issues raised by an amnesty, including the possibility that amnesty could have an adverse impact on taxpayer morale and thus voluntary compliance.

The President has not ruled out an amnesty as a means of collecting unpaid taxes from past years. Irrespective of amnesty, tougher compliance measures should be adopted to improve enforcement of our tax laws. Additional revenue agents should be hired to ensure that taxes owed are paid.

SUBCOMMITTEE RECESS

Senator ABDNOR. We did pretty well starting the week. If there is no further business to come before the subcommittee today, we will stand in recess until 2 p.m. tomorrow afternoon when we will review the budget request of the General Services Administration and National Archives and Record Administration and Executive Office of the President.

We stand in recess.

[Whereupon, at 4:20 p.m., Tuesday, March 18, the subcommittee was recessed, to reconvene at 2 p.m., Wednesday, March 19.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

WEDNESDAY, MARCH 19, 1986

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–124, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senator Abdnor.

GENERAL SERVICES ADMINISTRATION

STATEMENT OF TERENCE C. GOLDEN, ADMINISTRATOR

ACCOMPANIED BY:
- RAYMOND A. FONTAINE, COMPTROLLER
- WILLIAM B. EARLY, JR., DIRECTOR OF BUDGET

PREPARED STATEMENT

Senator ABDNOR. The hearing will come to order. Today we will continue with the fiscal year 1987 budget overview. The witnesses today will be Mr. Terence C. Golden, the Administrator of the General Services Administration; Mr. Frank Burke, the Acting Archivist of the United States, Mr. Christopher Hicks; Deputy Assistant to the President for Administration; and Mr. Manus J. Fish, Regional Director of the National Park Service, the National Capital Region. We have a full slate so I am not going to delay us by making a long opening statement other than to welcome you here today. The first witness is Terence Golden, the Administrator of General Services, and he is accompanied by Ray Fontaine, Comptroller, and Bill Early, Director of Budget. Gentlemen, it is a pleasure for me to welcome you to the committee, and your entire statement, Mr. Golden, will be made a part of the record, so if you care to summarize it or skip it, any way you want to, you just proceed.

[The statement follows:]

STATEMENT OF TERENCE C. GOLDEN

I am pleased to appear today in support of the 1987 budget request for the General Services Administration.

This budget will enable GSA to carry out its mission as the central administrative policy unit for the federal government and the provider of centralized services where it is cost-effective. As this Committee is aware, GSA's activities include information resources management, supply services, public buildings management, property resources, and acquisition policy. In carrying out its mission, GSA is an integral part of the Administration's objective to manage government efficiently and economically.

To put our request in perspective, GSA's total obligations will be approximately $7.5 billion in 1987. We have proposed new budget authority of only $401.5 million, with most of our operations funded by customers through payments for goods and services procured under the agency's revolving funds, by rental payments for space occupied in GSA-controlled space, or by direct reimbursement for services.

This budget has several major objectives. First, we wish to streamline the Agency and reduce costs wherever possible.

Our request of $401.5 million in budget authority for 1987 represents a reduction of $12.4 million below the amounts appropriated for fiscal year 1986. Our projected employment for 1987 is 22,648; this represents a decrease of 2,771, or 11%, below comparable 1986 levels.

These reductions reflect our commitment to operate with fewer resources in the future. To accomplish these savings we will delegate and contract out support functions, consolidate and streamline our operations, and reduce overhead activities. Our savings reflect consolidation of finance and administrative operations, delegation of buildings management functions to agencies, consolidation of warehouses and supply centers within the federal supply system, consolidation of information resources management functions, and organizational streamlining throughout the Agency.

Within this reduced total, we have provided for certain critical increases. In addition to covering inflation, we have budgeted $5.9 million for new ADP and operating equipment to increase the responsiveness and capabilities of our paper-based supply system. These investments are necessary to ensure the development of a modern, efficient federal supply system. We have also increased the budget for Inspector General activities by $1 million to combat potential waste, fraud, and abuse. We are committed to strengthening audit and investigative capabilities within the Agency.

A second major objective of this budget is to strengthen efforts to meet basic health and safety requirements and to modernize federal buildings. Under the Federal Buildings Fund, we are requesting an increase of $112.2 million, or 45%, for major repairs and alterations. Significant increases are provided: (1) to remove what are commonly known as PCB transformers, as required by the Environmental Protection Agency; (2) to conduct high priority asbestos abatement projects; and (3) to meet various fire protection requirements. This Agency has no priority greater than providing a healthy and safe workplace for federal employees.

For the Federal Buildings Fund, we are requesting $2.4 billion in new obligational authority, or approval to spend available revenues. As the Committee knows, Federal Buildings Fund revenues come from billing agencies at commercially equivalent rates for the space they occupy--the well-known Standard Level User Charges, or SLUC. In 1987, we are making a number of improvements to the way that these rates are set, such as more closely mirroring private sector rental practices, increasing participation of tenant agencies in developing rates, and providing for long-term rental agreements. These changes will help eliminate major rate fluctuations from year to year and promote greater stability in the Fund's revenues.

We believe that the revenues in the Federal Buildings Fund are adequate for Fiscal Year 1987. Given the requirements placed upon the Fund, the Administration is opposed to any attempt to place arbitrary restrictions on the amount of available revenues. Our requirements include the health, safety, and modernization needs; the reality of expiring, long-term leases at favorable rates where we will now face higher market rates; the need to purchase buildings where appropriate as a prudent investment; and significant operational responsibilities, including the law enforcement activities of the Federal Protective Service.

A third objective of this budget is to reduce government space and to delegate operational responsibilities for buildings management to agencies. Reducing the amount of space is a high priority of the Administration. This initiative will achieve reductions in the budgets of agencies throughout the federal government. Our delegations program is designed to provide agencies with the authority and responsibility to manage their own facilities. We believe that this will produce better managed facilities.

A fourth objective is to undertake an aggressive program to dispose of real property declared excess by federal agencies. The budget reflects an estimated $578 million in receipts from the sale of these properties, and we will need the support of this Subcommittee and the Congress to accomplish that target.

A fifth objective of this budget is to modernize the government's telecommunications system. We have an ongoing effort to replace the current, obsolete Federal Telecommunications System with a modern system that will handle voice and data. We intend to rely heavily on the private sector to design and operate this system, thereby gaining the economies and efficiencies available in the private sector. We anticipate that the revenues available in the Federal Telecommunications Fund will be adequate to support this modernization effort in Fiscal Year 1987. Over the long-term, we anticipate significant savings which will reduce agencies' budget requirements.

Sixth, and finally, our budget reflects efforts to streamline the federal supply system. Our belief is that GSA should be involved as a direct supplier only where there are demonstrable cost advantages to doing so. We have an ongoing project, in cooperation with other federal agencies, to streamline the existing system.

Before closing, I would like to discuss the effects of 1986 reductions under the Balanced Budget and Emergency Deficit Control Act or, as it is called, Gramm-Rudman-Hollings. Under this Act, an amount of $17.9 million in budget authority has been sequestered for GSA's accounts. We will achieve these reductions by implementing organizational and cost saving initiatives like those proposed in the budget for 1987. In some cases, we will accelerate our streamlining efforts. We do not anticipate any major reductions-in-force solely to meet the targets in Gramm-Rudman-Hollings.

We will need the assistance of this Committee, however, in that we do not anticipate the savings to be accomplished in the arbitrarily uniform manner prescribed in the Act. Accordingly, we will be asking the Committee's approval to reprogram certain 1986 funds between programs and accounts. If this is approved, we will be able to minimize the impact on the organization and its employees. We will avoid large scale employee furloughs, although selective furloughs as a last resort may be required if reductions are not achieved through other planned activities.

Mr. Chairman, this concludes my opening remarks. I will be glad to answer any questions that the Subcommittee may have.

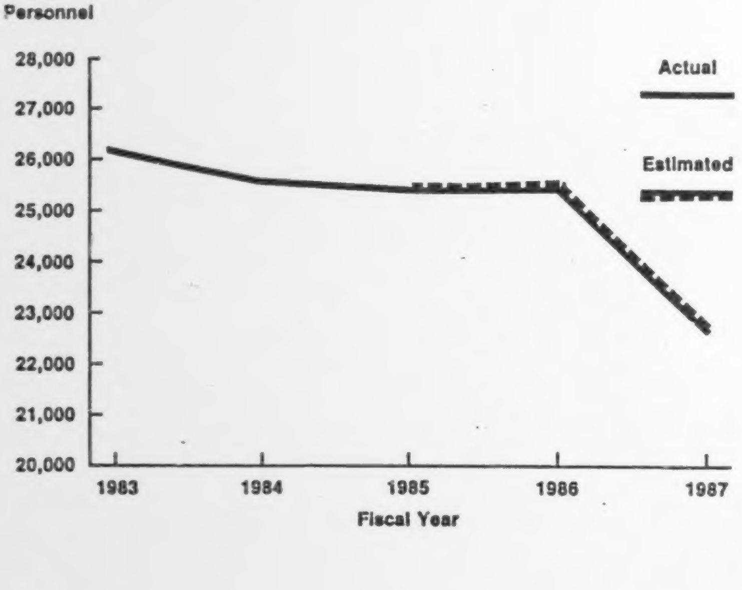
GENERAL SERVICES ADMINISTRATION BUDGET OVERVIEW

March 1986

Major Goals

1. STREAMLINE AGENCY
2. REDUCE SPACE UTILIZED BY THE FEDERAL GOVERNMENT
3. DEAL WITH CRITICAL SAFETY ISSUES IN FEDERAL BUILDINGS
4. MOVE TO OWNED SPACE WHERE ECONOMICAL
5. DELEGATE BUILDINGS MANAGEMENT TO AGENCIES
6. STREAMLINE FEDERAL SUPPLY SYSTEM
7. IMPROVE QUALITY OF MATERIAL PURCHASED BY THE FEDERAL SUPPLY SYSTEM
8. MODERNIZE GOVERNMENT'S TELECOMMUNICATIONS SYSTEM
9. REDUCE TIME REQUIRED TO ACQUIRE ADP SYSTEMS
10. INCREASE DISPOSAL OF SURPLUS FEDERAL PROPERTY

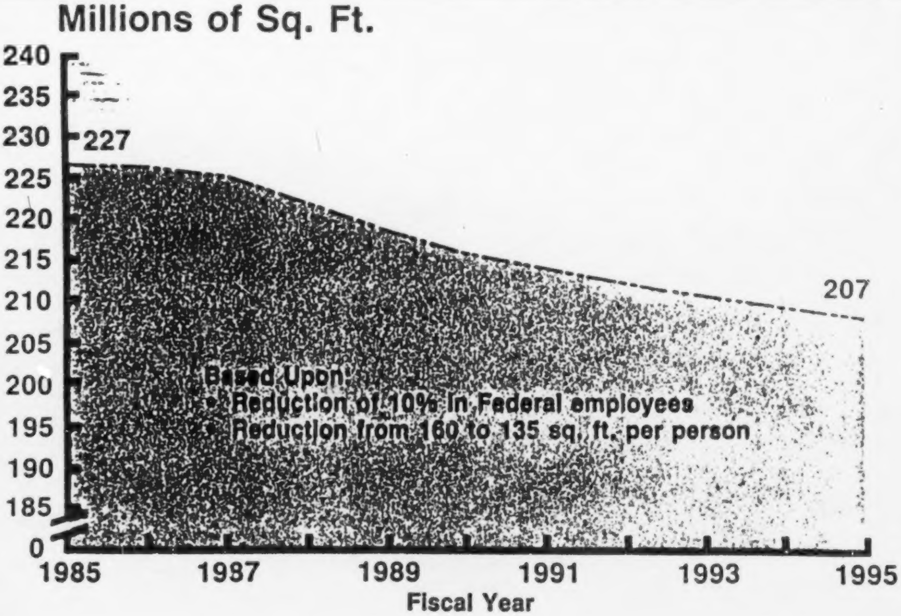
Staffing Reductions



Streamlining Actions Taken

- CONSOLIDATED TELECOMMUNICATIONS FROM 11 TO 5 ZONES
- CONSOLIDATED FINANCE FROM 5 TO 2 ZONES
- REDUCED SUPPLY DEPOTS BY 33%
- REDUCED CUSTOMER SUPPLY CENTERS BY 33%
- STREAMLINED PUBLIC BUILDINGS SERVICE, REDUCING CENTRAL OFFICE OVERHEAD BY 20%
- REDUCED CENTRAL OFFICE ADMINISTRATIVE OVERHEAD BY 10%

Impact of Space Utilization Improvements 20 Million Sq. Ft. Reduction in Leased Space

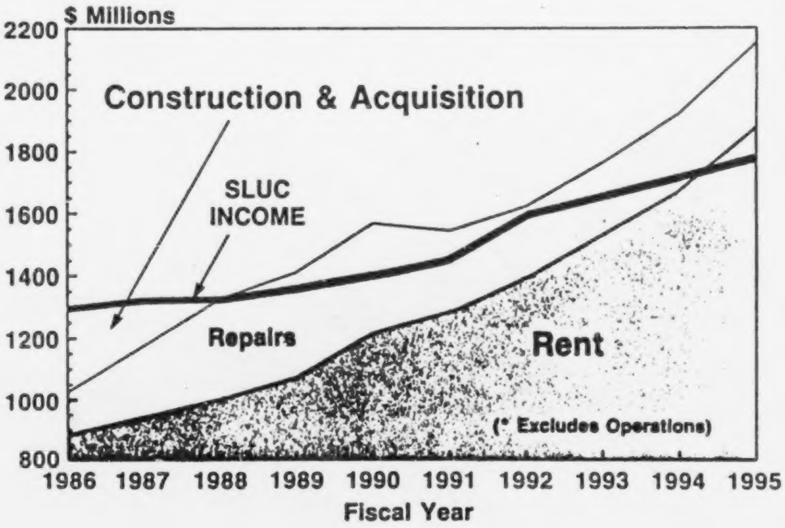


Based Upon:
- Reduction of 10% in Federal employees
- Reduction from 160 to 135 sq. ft. per person

Address Critical Health and Safety Issues

- ESTABLISHED A 5 YEAR PLAN TO DEAL WITH GSA'S MOST CRITICAL SAFETY ISSUES
    1. REPLACE ALL PCB TRANSFORMERS REQUIRED BY EPA ($93 MILLION)
    2. REMOVE ASBESTOS IN 45 HIGH PRIORITY BUILDINGS TO MEET OSHA REQUIREMENTS
    3. REMOVE FIRE SAFETY DEFICIENCIES BY 1988
- PROJECTS ARE ON SCHEDULE AND FUNDS ARE PROVIDED IN FY 86-87 BUDGETS
- PROGRAM WILL SATISFY CONCERNS OF UNIONS, GOVERNMENT AGENCIES, AND HEALTH/SAFETY EXPERTS

Expenses vs. Income *
(Business as Usual)



Delegate Buildings Management to Agencies

- GOAL IS TO DELEGATE BUILDINGS MANAGEMENT TO AGENCIES BY END OF FY 1986
  (EXECUTIVE ORDER 12512)

- INVOLVES 3,400 LEASED FACILITIES (52 MILLION SQ. FT.) AND 200 OWNED FACILITIES (25 MILLION SQ. FT.)
  REPRESENTS 1/3 OF INVENTORY

- WILL RESULT IN:
  - BETTER MANAGED FACILITIES
  - GSA CONCENTRATING ON ASSET MANAGEMENT
  - REDUCTION IN GSA FIELD OFFICES (30%) AND POSITIONS (2,300)

Reform Federal Supply System

- STUDY IN PROGRESS TO RESTRUCTURE FEDERAL SUPPLY SYSTEM

- ACTIONS TAKEN TO DATE
  - CLOSED 33% OF DEPOTS AND SUPPLY CENTERS
  - DELEGATED PROCUREMENT OF SINGLE AGENCY ITEMS BACK TO AGENCY
  - REDUCED INVENTORIES IN DEPOTS BY 10%
  - REDUCED CONTRACTS UNDER SCHEDULE BY 500
  - ORDERED DIRECT DELIVERY OF LARGE QUANTITY ORDERS

- LONG-TERM GOALS
  - MAKE SYSTEM MORE RESPONSIVE TO AGENCIES' NEEDS AND REQUIREMENTS
  - GSA PROCURES SERVICES AND MATERIALS ONLY WHEN THERE ARE SIGNIFICANT SAVINGS

Modernize Telecommunications System

EXISTING SYSTEM	PROPOSED SYSTEM
ANALOG	DIGITAL
OUTDATED	STATE-OF-THE-ART
MAINLY VOICE	VOICE, DATA, VIDEO
MANAGED BY GSA	MANAGED BY PRIVATE INDUSTRY
SUBSTANTIAL CAPITAL INVESTMENT; COSTLY TO OPERATE	NO CAPITAL INVESTMENT; SERVICES PURCHASED AS NEEDED

STATUS:

- REVIEWING INDUSTRY/OMB/AGENCY COMMENTS ON PLAN
- AWARD FOR NEW SYSTEM IN EARLY 1987
- POTENTIAL GOVERNMENTWIDE SAVINGS: $100,000,000 PER YEAR

Reduce Time Required for Acquiring ADP Systems

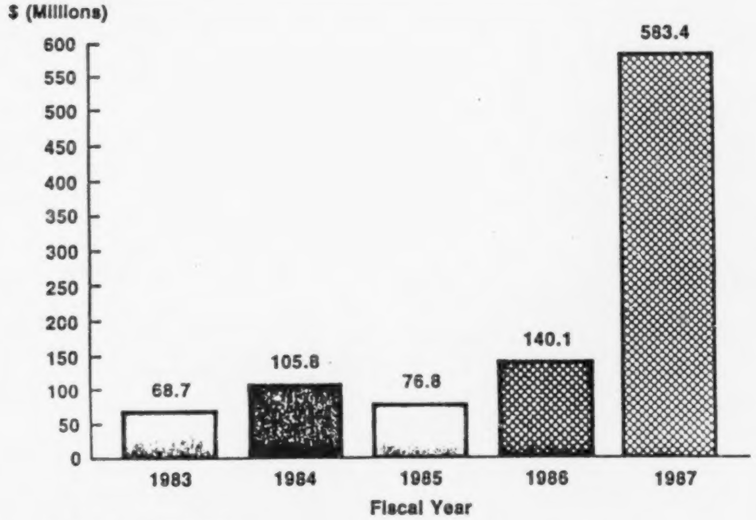
- CURRENT ADP PROCESS—FROM CONCEPTION OF PLAN TO INSTALLATION OF EQUIPMENT—TAKES ABOUT 3–8 YEARS.

- GOAL IS TO REDUCE THIS PROCESS SIGNIFICANTLY. ADDITIONAL GOAL IS TO REDUCE THE ACQUISITION TIME TO 12–18 MONTHS.

- PILOT PROJECTS HAVE BEEN INITIATED WITH NAVY, HHS, NASA, AGRICULTURE.
  - — WILL CONDUCT PARALLEL FINANCIAL AND SYSTEMS REVIEWS WITHIN AGENCIES AND WITH EXTERNAL REVIEWERS (GSA AND OMB).
  - — RESULTS ANTICIPATED IN 1987 AND 1988.

Disposal Sales Program

(Annual Receipts)



(FY 86 and 87 are projections.)

INTRODUCTION OF ASSOCIATES

Mr. GOLDEN. Thank you, Mr. Chairman. I also wanted to mention that I have with me today the Commissioner of the Public Buildings Service, Bill Sullivan; Don Gray, the Commissioner of the Federal Supply Service; Frank Carr, the Commissioner of the Information Resources Management Service, and Earl Jones, the Commissioner of the Federal Property Resources Service; as well as Gary Kowalczyk, the Associate Administrator for Planning.

Senator ABDNOR. That is good. We will be able to ask you any questions.

Mr. GOLDEN. You can ask any questions you wish. I am sure we can answer them. I would like to briefly give you an overview of where we are at GSA, and then I will be happy to answer any questions that you have.

Senator ABDNOR. Very fine.

MAJOR GOALS AND OBJECTIVES

Mr. GOLDEN. When I came to GSA, one of my top priorities was to work with senior management and political appointees of the agency to establish the goals and objectives for the agency. What we outlined last year was really an identification of the major goals that we would like to accomplish over the next 4 or 5 years.

Listed here are the major goals and objectives. I would like to go through them briefly and discuss each of them individually. As far as streamlining the agency is concerned, the proposed budget accomplishes that objective. For fiscal year 1986, our staffing level is 25,399 employees. Our projections are that for fiscal year 1987, we will be operating at a level of 22,628, a decrease of 2,771 personnel.

Our proposed budget for fiscal year 1987 is $401 million. Compared to the budget that was approved by you in fiscal year 1986 of $413.8 million, it represents a reduction of approximately $13 million. When you take into consideration the adjustment for Gramm-Rudman-Hollings, it is basically a flat budget from 1986 to 1987, so we have made a number of efforts to reduce costs overall.

Let me briefly summarize some of the actions that we have taken to reduce our costs. What we have endeavored to do is to streamline the agency in every way we can. We concluded that in the telecommunications area, for example, that rather than operating out of 11 regional offices, we can operate in five zones and achieve some significant reductions.

We have been very successful in consolidating the finance function into two specific locations, Kansas City and Fort Worth, which is a reduction from five to two locations.

In the Federal Supply Service we have also reduced the number of supply depots and the number of customer supply centers by 33 percent.

Finally, as part of our efforts to cut costs, we evaluated all of our organizations to see if we could reduce the amount of redundancy, the number of deputies, and whatever else it took to reduce costs, and we made some significant reductions overall in our administrative overhead within the agency.

Within the Public Buildings Service, we are making a major effort to see if we cannot reduce the amount of space being utilized by the Federal Government.

It is our projection that we should be able to accomplish roughly a 20-million-square-foot reduction in leased space by 1995, and that as a result of this, we will have significant savings. To help put that figure in perspective, 20 million square feet is approximately twice the amount of square footage in downtown Minneapolis. So we really have the potential of saving the square footage of two intermediate size cities worth of buildings if we are successful with this program.

We are assuming that there will be some slight reductions in the Federal work force over this time. We are also assuming that we are going to reduce from 160 square feet per person to 135 square feet per person, as well as get involved in a number of consolidations and relocations to accomplish that objective.

We also wanted to address what I think is a very important consideration, and that is the health and safety needs of our employees. I think all of us have to recognize that within the Federal Government the average age of the federally owned space is over 35 years. It is in need of a number of improvements to protect the health and safety of the occupants of those buildings.

We have established a 5-year plan to deal with GSA's most critical safety issues. They include replacing the PCB transformers in Federal buildings, removing friable asbestos from the 45 high priority buildings that we have identified, and correcting other fire safety deficiencies by installing sprinkler systems in some of our older buildings.

Finally, we have one other initiative which I think is very significant. I recently visited with the Surgeon General, Dr. Koop, and we discussed the $650 million 5-year program for health and safety.

He indicated to me that there is one action we could take to greatly improve the health of our employees without a major expenditure, and that was to see if we could not create a smokeless environment within our buildings. He indicated that each year there are over 5,000 lung cancer deaths caused as a result of passive smoking. So we are going to make some significant improvements in that area as well.

I have mentioned before that one of the biggest concerns I have for this budget period is not the actions that will be taken by this committee, but the actions that will be taken by other committees to freeze SLUC. These charts show our budget projections for SLUC income, the income we receive from other agencies to manage the buildings. Based on the dramatic increases that will occur in rents and repairs that we have within our buildings, if SLUC were frozen, it would result in a $170 million reduction to the income of our fund. We would have to reduce our repairs and alterations program, which would greatly damage our ability to do the things that we need to do within GSA.

What I would like to ask you, if I may, is that when you have an opportunity to visit the other committee chairmen to get their cooperation and support, to point out to them that if they are going to reduce SLUC payments, what they need to do is reduce the amount of space for which SLUC payments are made, and not reduce the rates themselves.

SLUC FREEZE

Senator Abdnor. How much does that go up a year usually? How much did you say would be cut if we froze it?

Mr. Golden. If SLUC were frozen, it would represent approximately a $170 million reduction in revenues. As you can see by this chart, it would force us to cut back in our repairs and alterations budget dramatically, principally in the areas that we have targeted now in fire and safety. This is a major concern from our point of view.

Senator Abdnor. How much does that represent as a percent of increase, that $170 million?

Mr. Golden.As you can see, our current budget estimate for SLUC income is roughly $2.4 billion. Many of those expenses involve just ongoing safety and security, and ongoing maintenance of the buildings.

As far as our major capital program is concerned, it is $534 million. So that reduction, although it is not significant in the overall, would represent roughly a 32-percent reduction in our overall capital program.

Another major program we have is delegating building management to tenant agencies. We are in the process now, for those buildings where there is a single tenant, of delegating responsibility for the normal maintenance of those buildings to that single tenant. We think that this is going to result in some savings. We also think it is going to greatly enhance the management, quality of work, and the environment within those buildings.

We have had a pilot program in the Justice, Transportation, and Labor buildings, for example, that has been underway for several years, and it has worked out quite well. The agencies are, in fact, doing their own management, and are very satisfied with the program.

Within the Federal Supply Service, we have made some short-term improvements within the supply system such as the closing of depots, the delegation of procurement of single agency items back to the agencies, and a reduction in inventories overall.

This year we are going to reevaluate what we are doing within the Federal Supply Service. I think the underlying philosophy is a very simple one, and that is where an agency can procure an item faster and cheaper, then we think they should do it. But where we can clearly establish that there is a substantial savings to the Federal Government by having GSA aggregate the needs of the agencies and buy in a bulk way, then we are proposing that we do that.

When we evaluated our current system we discovered that there were a number of inefficiencies. For example, one relates to the Department of Defense. Currently, we are providing them with a number of spare parts, specialty lubricants, and sealants for their aircraft. They are our only customer for those items. What is happening is that DOD is doing business with us, and they probably have as many people involved in this procurement as we have dealing with the vendor. It seems to me that it wold be a lot more efficient if for specialty items where they are our only customer, they would deal directly with the vendor and bypass us. I think it would streamline their operations, and certainly the taxpayer would benefit as well.

We can also make some major improvements in our depot operations by computerizing the paperwork and processing of inventories; and also, by reducing the inventories themselves.

We have a major program underway in the Information Resources Service to modernize our telecommunication system, to move from the current system which is not very cost effective and is outdated in the sense that it can only handle voice communications, and not data transmissions. It has been projected that by !993, over 50 percent of the long-distance communications within the Federal Government are going to be data transmissions.

What we propose is a fully digital system, one that is managed by private industry which will not require capital investment, nor an ongoing operational requirement on the part of the Federal Government. I think this is really consistent with the President's goal of privatization. We would be buying services as needed, and we would have a fully up-to-date system that is owned and operated by the private sector.

Our estimates are that we will save in excess of $100 million a year as a result of this program. Within our ADP area where we are responsible for the acquisition of ADP systems for Government, we are trying to see if we cannot reduce the amount of time it takes to acquire a system.

Currently, it takes anywhere from 3 to 8 years to purchase a major computer system within Government. Many times when a computer is actually delivered, it is already one generation behind because of our acquisition process.

We have a pilot program underway involving Navy, HHS, NASA, and Agriculture, and it is our sense that with their help and cooperation, we might reduce this time significantly.

Finally, there is another area where we would greatly appreciate some cooperation, particularly from this committee in helping us with other committees. We are embarking upon a major program of doing a more efficient job of managing the Government's assets, identifying those assets which are unneeded within the Federal Government, and disposing of them, and thereby, helping to reduce the Federal deficit. It is a program where we are going to run into some opposition since everyone has their own pet project that they think the Government should keep, and we need every bit of help we can get.

That briefly summarizes where we are, and I would be happy to answer any questions you have, Mr. Chairman.

REAL PROPERTY DISPOSAL

Senator ABDNOR. Thank you, Mr. Golden. Starting where you ended, what will be some of those sale programs, disposal? Are we talking about buildings or what?

Mr. GOLDEN. If we look at that last chart, we are roughly talking about $583 million for disposal this next year which represents a dramatic increase over our projected results for 1986 which are $140 million. I might add that we are off to a good start in the sense that OMB and GSA are working together on this program. Director Miller from OMB is a strong supporter of the program, and this year for the first time the budgets from OMB to the various agencies have included specific properties to be disposed of.

Those particular properties were contested in several cases by the agencies involved and resolved by the White House. So we have a much better sense of what properties we would like to dispose of, and I think we have the cooperation and support of OMB and the White House in that regard.

Senator ABDNOR. I am sure you have OMB. There is no doubt in my mind. I do not have any problems with that. As a matter of fact, I would not doubt if they encouraged you quite a bit. I was just curious what they might be. I mean are they buildings you are talking about?

Mr. GOLDEN. I have a list here which I would be happy to furnish to you. In many cases, it involves properties.

Senator ABDNOR. If we could, we would like to have it for the record.

Mr. GOLDEN. We would be happy to provide that.

Senator ABDNOR. Good. Thank you. That will take care of it.
[The information follows:]

POTENTIAL EXCESS PROPERTIES

THIS LIST IS FOR PLANNING PURPOSES ONLY

Holding agency	Property	Acres
Transportation	USCG Transmit Station, San Mateo Pt., San Clemente, CA	40.3
	USCG Marine Inspection Office, New York, NY	1.7
	Transportation System Center, Cambridge, MA	14.0
	Subtotal	56.0
Navy	HOLF Mile Square, MCAS Tustin, Orange County, CA	137.0
	Glenview Naval Air Station, Glenview, IL	1,442.0
	Marine Corps Recruit Depot, San Diego, CA	432.0
	Subtotal	2,011.0
Army	Fort Sheridan, Lake County, IL	100.0
	Ravenna Army Ammo Plant, Ravenna, OH	5,800.0
	Presidio of Monterey, Monterey, CA	81.0
	Fort McPherson, GA	505.0
	Subtotal	6,486.0
Air Force	Air Force Plant No. 36, Evandale, OH	50.0
	Air Force Plant No. 19, San Diego, CA	70.3
	Subtotal	120.3
NASA	Plumbrook Station, Sandusky, OH	5,500.0
GSA	Raritan Arsenal, Raritan, NJ	200.0
	Custom House, Boston, MA	0.9
	Block 111, Denver, CO	1.1
	Subtotal	202.0
Veterans Administration.	VA Medical Center, West Los Angeles	109.0
	VA Medical Center, Sepulveda, CA	46.0
	Subtotal	155.0
	Total (18 properties)	14,530.3

List of potential excess properties, by holding agency, that are included as part of the fiscal year 1987 receipt target estimate of $578 million.

STREAMLINE PUBLIC BUILDINGS SERVICE

Senator ABDNOR. I notice you said you are going to streamline the Public Buildings Service, reducing overhead by 20 percent. That is quite an ambitious goal. How are you going to do that?

Mr. GOLDEN. There are a number of things that we can do. As a result of Gramm-Rudman-Hollings and a tight budget, we are not involved in a heavy construction program. For fiscal year 1987, we have included in our major capital program no major construction; instead we have requested $93 million to be used for the acquisition of buildings for the Federal Government.

I see our construction of major buildings reducing, and that has been a factor. I also think we can streamline our operations. We have reassessed where we are in our 11 regions. We have discovered that we do not need the same level of service and the same amount of overhead in all 11 regions. In many cases, particularly in the cases of region 1, which has headquarters in Boston, region 8 headquartered in Denver, and region 10 in Auburn, WA, we can provide a minimum level of service and get additional service from neighboring regions. We will be able to reduce our costs dramatically as a result of that.

REDUCTION IN FORCE

Senator ABDNOR. How are you going to attain some of these goals? Are you going to have some RIF's going on?

Mr. GOLDEN. We are doing everything we can to avoid RIF's. No. 1, in those areas where there are reductions, we have worked with our unions. We have established a hiring freeze within the agency so that when a job becomes available we try to fill it with someone who has been affected as a result of a change.

We also have an aggressive program of trying to place our employees with other Federal agencies, and we have been very successful. There have been several agencies such as DOD who have been doing a lot of hiring, and we have been able to place some employees there.

We are also initiating a program of early-outs for individuals who want to take benefit of that program. In any case, what we are doing is our maximum to avoid RIF's. However, there are situations within the agency where we are going to have RIF's. Particularly, that is true in the case where we are closing a depot or a customer supply center, or where an operation in its totality is no longer required.

Senator ABDNOR. I am sure it is just human nature that you are finding a lot of resistance where you are doing some of these things?

Mr. GOLDEN. It is a real challenge for all of us. I think the pressures of the budget are severe. What we are trying to do with the resources we have available is to the best of our abilities, provide the services that we need to provide. I personally feel that I have gotten a lot of cooperation from the employees within GSA.

REPROGRAMMING

Senator ABDNOR. Good. We have touched on the Gramm-Rudman-Hollings and your problems, how overall it has impacted GSA, and is that as much as any reason why you brought on this reprogramming?

Mr. GOLDEN. We did need to do some reprogramming to accomplish the Gramm-Rudman 4.3 percent reduction. I think we can absorb that without reducing our level of service overall. So I am satisfied that the reduction at least as it relates to GSA is one that we can live with.

But in order to accomplish this, we have had to reprogram funds in several areas. We needed to transfer $1.6 million between appropriations. There were two areas where I felt we needed to restore the money that was being reduced by Gramm-Rudman. One was in the Office of the Inspector General, in order to continue our program of dealing with waste, fraud, and abuse. So we have reprogrammed $190,000 so that we could maintain the Office of the Inspector General to the extent that we could.

Senator ABDNOR. Is that for this year, for 1986?

Mr. GOLDEN. That is for 1986. Within the Federal Supply Service we had a major problem in the sense that the 4.3-percent reduction had to be taken from the "Operating expenses" account from which personnel are paid. It was difficult without RIF's to accomplish that. What we have done is taken reductions in other areas within the agency, and reprogrammed those funds to the Federal Supply Service. That amount is $1.4 million.

SUPPLEMENTAL, ATLANTA CLAIM

Senator ABDNOR. Before we get into the 1987 request, I want to get a couple of things on record. It is my understanding that the supplemental request for the claim in Atlanta will not be necessary?

Mr. GOLDEN. As far as the claim in Atlanta is concerned, litigation has not yet been completed, and funds will not be required in 1986. When the claim is settled, Treasury will make the payment, and we will request funds to reimburse Treasury after that has occurred.

Senator ABDNOR. That will take care of your obligation?

Mr. GOLDEN. That will take care of that, yes.

TRANSPORTATION AUDITS

Senator ABDNOR. The transportation audit language that the committee placed in last year's bill has been quite effective. Should and can more be done to increase collections?

Mr. GOLDEN. This has been a very successful program as far as we are concerned. We have in 1986 projected that we will collect some $17 million in overcharges to the Government. We currently have a cap on the program of some $5.2 million. However, this level of contractor production can be increased to $24 million in 1986 if the current limitation can be raised to $7.6 million on payments to contractors from proceeds of audits. What we are proposing is that we raise that cap to $10.5 million in 1987. We project contractor production to be $30 million assuming the limitation is raised.

As a result of that, it is our expectation that net of expenditures we pay our contractor that we will save the Government some $20 million. So it has been a very successful program I think not only in terms of collecting revenue for the Government but also putting the industry on notice that we are monitoring their charges carefully. I think as a result of that, we are going to end up with a lot less waste and abuse in that particular area.

ASBESTOS REMOVAL

Senator ABDNOR. Great. The GSA budget for repairs and alterations is concentrating on the removal of asbestos and PCB's. This year begins the first stage. How long will it take to complete this effort, and how costly is it going to be?

Mr. GOLDEN. It is our estimate that it will take approximately 5 years to complete the program. We have done a detailed survey of all of our buildings and have identified those buildings where we have major problems with friable asbestos. We have embarked upon a reasonable program to remove that asbestos.

Senator ABDNOR. Do you have people to do that yourself, or do you contract that out?

Mr. GOLDEN. In the majority of cases, we will be finding outside contractors to do that work.

LIABILITY INSURANCE

Senator ABDNOR. I know there is quite a need for them. I know a group of them stopped in my office. We have been involved with the asbestos in schools in another committee, and we have introduced legislation on that. They were telling me the real problem they are having as contractors is getting liability insurance.

Mr. GOLDEN. We have had problems not only with construction contractors but architects, as well. Our initial problem, particularly with this program, has been in identifying architects whose insurance carriers would cover their working on designs relating to asbestos.

We are going to have some delays as a result of this insurance coverage problem. The cost of removal is going to increase dramatically because of it. But we feel that because of the magnitude of the work involved, and the industry's better understanding of the technology, we will find contractors who are well-insured, and who can do the job. It is a little bit up in the air right now, though, I have to say.

MAINTENANCE OF FEDERAL BUILDINGS

Senator ABDNOR. In recent years we have deferred considerable maintenance, and it is a lot like the highway and bridge repair problems. Could you give us a brief summary of the maintenance staff of the Federal buildings?

Mr. GOLDEN. As I indicated before, we have made a major improvement in the sense that we have increased the amount of maintenance that we are funding in our budget. What I call our major repairs and alterations budget has gone from $121 million to roughly $216 million, a significant increase overall, and those increases have been directed primarily toward fire and safety.

Our overall inventory of buildings within the Federal Government is, on the average, over 35 years of age, and we have roughly 2 billion dollars' worth of modernization efforts that will be required. At some point we really do need to get on with a program of getting those buildings modernized. I think good examples of that are the Pentagon Building in Virginia and the Federal Triangle in Washington, DC. Those buildings are old and in need of major repairs.

Senator ABDNOR. Does that mean you will have to raise the SLUC fees even higher?

Mr. GOLDEN. At some point we are going to have to reach a decision as to what we do. This year we did increase our overall repairs and alterations budget and gave first priority to fire and safety issues. Next year we are going to reassess where we are overall.

Senator ABDNOR. One last question, are State and local governments continuing to receive surplus properties, or has the sales program taken these governments out of the cycle?

Mr. GOLDEN. We have continued with that, perhaps at a reduced level, but States and local governments are still benefiting from the program overall.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. We have a number of questions we will submit in writing. I might say Senator Domenici has several questions for the record, and so does Senator Mattingly and Senator DeConcini, who could not be here today, and who is a big part of this committee. So if you do not mind, we will give you something to do. You have all that manpower. We will put them to work.

Mr. GOLDEN. That would be great. Thank you, sir.

Senator ABDNOR. Good. We want to commend you and your people on the job that you are doing. We know that you have a difficult challenge before you, but you seem to be making a lot of headway. Thank you very much.

Mr. GOLDEN. Great. Thank you, Mr. Chairman.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

QUESTION: The largest part of the funding being requested for new construction is in the opportunity purchase program. As you know, I believe this is a very effective way to secure new federal properties. Could you briefly review where we are today?

ANSWER: To date, Congress has authorized $156 million for this program. GSA has purchased three buildings for $48 million. These buildings are located in Dallas, TX; Austin, TX; and Washington, DC.

We are presently negotiating for the purchase of two buildings, and several more purchases are under evaluation by our headquarters staff. These potential purchases have a cost advantage over leasing of 22% to 30%. We expect that all of the currently available funds ($108 million) will be committed by the end of this fiscal year.

The $93 million requested in FY 1987 is essential to making continued progress in reducing costly leased space.

QUESTION: In that same line could you give the Subcommittee a status update on the Oakland project?

ANSWER: GSA supports the construction of this building because it will replace costly leased space throughout the Bay Area. Congress added $8.1 million for design of this project to the FY 1986 budget. GSA submitted a prospectus requesting authorization of the design phase of the project on March 14, 1986. Design will begin in FY 1986. Our preliminary plan is to request construction funding in FY 1988. The total estimated project costs for a new Federal Building in Oakland, CA is $143 million.

QUESTION: The building delegation program is moving forward. What departments are currently participating? How are they coping with the change?

To date, delegations have been issued to 11 agencies. The agencies currently participating are:

Agriculture
Commerce
Energy
Health and Human Services
Housing and Urban Development
Justice
Labor
Transportation
Treasury
Central Intelligence Agency
Railroad Retirement Board

The agreements are working well and the agencies are highly satisfied.

QUESTION: I don't quite understand the accounting procedures being used with regard to the delegation. Could you briefly explain it? In your opinion, could it be less complicated?

ANSWER: Under the pilot program we have two different budgetary procedures in place. For locations delegated prior to FY 1985, we provide operating funds to the agencies via the SLUC chargeback process. For locations delegated since FY 1985, we are transferring operating funds to the agencies during budget execution. By FY 1989, when all of the pre-1985 delegation agreements have expired, we will be transferring funds to all delegatee agencies during budget execution. GSA will monitor agencies' actual expenditures through periodic reporting mechanisms.

After we have had some experience with this system, we will review our procedures for possible simplification.

QUESTION: Many of the alteration projects are the requirement of the Omnibus Judgeship Act. What is the projected need? Are these judges sharing space or are we building new courtrooms for every one?

ANSWER: The estimated current alteration cost for the 48 projects required to satisfy the Omnibus Judgeship Act is $23 million. These costs are budgeted over a 4-year period as follows:

FY 1985	$1 million
FY 1986	$3 million
FY 1987	$13 million
FY 1988	$5 million

Under the Act, each judge gets a new courtroom.

QUESTION: The Purchase Contract program has seen an effort to pay off some buildings and effectuated a savings in payments as well as taxes. Is there a plan to continue with this buyout procedure? How many buildings would be affected? Is there any cost-related data?

ANSWER: Savings of approximately $2.2 million will be realized in FY 1987 through early buyouts executed in FY 1985. There are no current plans to pursue additional buyouts. As a result of current low market interest rates there is little or no advantage to the government of early buyouts at this time. If market conditions in the future indicate that buyouts would be economically advantageous to the government, and funds are available to pursue such actions, GSA will resume buyout efforts.

A total of 68 projects were constructed under the purchase contract authority provided by the public buildings amendments of 1972. Four of them have been bought out.

QUESTION: I note that the space requirements on a government-wide basis is down. Are we getting out of leased space and into government space?

ANSWER: Yes, we are reducing the leased space inventory. In FY 1979 we had 93.3 million square feet of leased space, representing 41% of our total inventory. In FY 1987 under our proposed budget we will have 86.2 million square feet, representing 38% of our total space inventory.

QUESTION: The Federal Government currently has about 86 million square feet of leased space. Is there any hope of reducing that level? Has GSA given any thought to what is the absolute lowest footage for leased space?

ANSWER: At the end of FY 1985 the leased space inventory was 88 million square feet. There are several initiatives underway to reduce that figure. They include:

- the building purchase program;
- construction of new Federal Buildings, such as Los Angeles and Oakland;
- alteration of underutilized Government-owned properties, such as the Mart Building in St. Louis;
- consolidation of agencies at a single location for maximum efficiency; and
- the Workspace Management Reform program to reduce the average utilization rate to 135 by 1990.

In addition, GSA has developed a 5-year space reduction plan to reflect the requirements of Gramm-Rudman-Hollings and the Administration's fiscal priorities. This plan incorporates a number of incentives and enforcement measures to achieve significant reductions in the leased inventory.

The target for FY 1990 is 77 million square feet of leased space.

QUESTION: Are agencies doing all they can to reach the 135 square foot requirement, or are they just complaining? Are we seeing an effort to reach this goal or are we seeing an effort on behalf of agencies to get space reclassified so it won't be affected? Are some agencies better than others? What is the excuse for not getting down? Are you getting any help from the White House?

ANSWER: FPMR Temporary Regulation D-71, Workspace Management Reform, requires Federal agencies to achieve an average utilization rate of 135 square feet per employee by 1990. A supplemental space policy allows agencies to exclude mission related needs for reception areas, processing areas, etc., from utilization rate calculation. This regulation was developed in consultation with the Cabinet Council on Management and Administration (CCMA) Working Group on Real Property Management which consisted of representatives of ten Federal agencies. Many other Federal agencies had an opportunity to review and comment on the CCMA findings. FPMR D-71, therefore, reflects the views and has the support of Federal agencies. We also believe that most agencies are making a good faith effort to comply with the D-71 requirements. We see no effort by agencies to reclassify space to achieve their goal. The White House, through the President's Council on Management Improvement, is behind this program and is supportive of GSA's efforts.

There has been a problem in developing supplemental space data required by D-71 in a timely manner. Agencies report that staff reductions and the press of other priorities have negatively impacted this effort. GSA is continuing to advise agencies of the need to submit this data on a timely basis and to work with them toward this.

The following chart compares FY 1983 and FY 1985 office utilization rates for the top 20 agencies.

SPACE UTILIZATION RATES
TOP 20 AGENCIES

AGENCY	OFFICE UTILIZATION RATE FY 1983	OFFICE UTILIZATION RATE FY 1985	CHANGE FY 1985 VS FY 1983	PERCENT CHANGE
EXECUTIVE BRANCH				
Health & Human Services	160	158	-2	-1%
Treasury	136	135	-1	-1%
GSA (minus Joint-use, Outleases)	143	141	-2	-1%
Defense	131	129	-2	-2%
Justice	175	166	-9	-5%
Interior	163	166	3	2%
Army	152	150	-2	-1%
Agriculture	158	151	-7	-4%
Transportation	178	161	-17	-10%
Veterans Administration	174	170	-4	-2%
Commerce	168	163	-5	-3%
Labor	187	167	-20	-11%
U.S. Postal Service	109	94	-15	-14%
Energy	171	178	7	4%
HUD	163	158	-5	-3%
EPA	172	134	-38	-22%
State	194	132	-62	-32%
Executive Office of the President	158	157	-1	-1%
Office of Personnel Management	212	180	-32	-15%
JUDICIAL BRANCH				
U.S. Courts	446	426	-20	-4%
NATIONWIDE (ALL AGENCIES)	164	159	-5	-3%

A-76 Process

QUESTION: Contracting-out has become an issue of considerable discussion. In your view is it working, and more importantly, is it as cost effective as original projections.

ANSWER: The OMB Circular A-76 process, to which you refer, is not a program designed to contract-out Rather, it is a formally structured process which permits agencies and the private sector to compete to determine who can provide needed goods and services at the lowest possible cost to the taxpayer. A-76 actions can and do result in decisions to contract-out and when that happens the General Services Administration (GSA) undertakes every effort to mitigate the effect of that decision on it employees The critical point that is often missed, however, is that the risk of contracting-out is providing agency managers with new incentives to review their operations and develop more efficient and cost effective ways of performing work in-house and to compete more effectively with the private sector. As a result, significant savings are being generated whether the function is retained in-house or contracted-out to the private sector.

To date, GSA has reviewed 3,500 positions under the A-76 program. The vast majority of these positions have been custodial functions in remote locations involving 1 and 2 employees each. Many of these functions have been converted directly to contract performance, yielding savings of 40 to 60 percent Overall GSA has converted 2,500 positions to contract performance or 70 percent of those reviewed. The remaining 30 percent were competed against the private sector and retained in-house.

To date, GSA has received approximately $22 million in annual savings, approximately $100 million in total, without any reduction in service and at minimal cost to the taxpayer. Indeed, in almost every case, the A-76 process has improved service while reducing cost. As GSA begins to submit its larger, more complex functions to review, we expect even greater savings, both as a result of conversions to contract and as a result of improved management studies and in-house efficiencies.

To conclude, we believe that the OMB Circular A-76 continues to be a cost effective method for determining efficiencies. Significant savings have been gained by contracting-out. Significant savings have also been gained through the development of efficient in-house bids. We consider it to be one of our most important and most cost effective management review programs. We intend to pursue the A-76 program vigorously and to expand the techniques and lessons learned through the A-76 process to inherently governmental positions as well.

Telecommunications

Question:

Telecommunications have been a priority in recent years. Where is the Federal Government in its upgrading process?

Answer:

We have no data concerning the overall status of upgrading Federal Government telecommunications. The Federal Telecommunications System (FTS), operated by GSA as a common user system for mainly voice communications, forms less than 15% of Government communications. The FTS has been undergoing competitive replacement for several years with all of the transitions to new systems scheduled by 1990. Replacement of both local and long distance service are underway. These replacements will bring state-of-the-art integrated voice and data communications to our users. The overall programs are broken into three major projects: 1) the Aggregated Switch Procurement (ASP) covering national local service with the exception of Washington, DC, 2) the Washington Interagency Telecommunications System (WITS) covering local service in Washington, DC, and 3) FTS2000 covering long distance service.

ASP

GSA currently manages about one-quarter of the local service systems serving over one-half the users on the FTS network. We have been competitively replacing these systems with new technology since 1977 and since 1983 have accelerated replacement in our ASP program. So far 179 systems have been competitively awarded. New England was chosen as the ASP Pilot which was awarded to ATTIS in March 1985. As of today, nine systems have been cutover in New England with the remainder scheduled for cutover by mid-1986.

WITS

WITS is an upgrade of the current C&P government centrex network in Washington, DC, Maryland, and Virginia, and will be bringing integrated voice and data services to subscriber agencies. Cutover will begin in 1988 and complete in 1991. It is expected to serve 150,000 users in over 100 agencies at 25% below the current cost. The concept for the replacement was the result of an interagency task force in the early 1980's. The request for proposals (RFP) is being prepared for release in May 1986, with proposals due in November and contract award by April 1987.

FTS2000

The FTS2000 project will replace the current FTS long distance network. This project is different from the ones above as it is a procurement for services rather than for equipment. Full integrated voice, data and even video and packet switching services are being solicited. The project was publicly announced in January 1985 and a draft RFP was made available for industry and agency comment in October. The RFP is currently being revised and amended prior to final release later this year. Award will be in 1987, with transition beginning 6 months after award and cutover being completed by 1990.

Board of Contract Appeals

QUESTION: THE BOARD OF CONTRACT APPEALS IS BECOMING MORE AND MORE ACTIVE. A SIZEABLE INCREASE IN PROTESTS IS PROJECTED. RECENTLY THE BOARD ISSUED A RULING ON AN IRS ADP BID WHICH WAS VERY SPECIFIC IN SCOPE. THE RULING WILL BE MOST COSTLY TO THE IRS AND I AM FEARFUL WITH THIS TYPE OF STRICT RULING EVERY CONTRACT AWARD WILL BE PROTESTED ON THE SLIGHTEST TECHNICALITY. CAN ANYTHING BE DONE TO INSURE THIS SORT OF SITUATION FROM DEVELOPING?

ANSWER: THE QUESTION APPARENTLY REFERS TO THE SPERRY AND SYSOREX PROTESTS THAT WERE RECENTLY DECIDED BY THE BOARD.

THE CONTRACT AWARD THAT WAS CHALLENGED IN THE SPERRY AND SYSOREX PROTESTS WAS HELD BY THE BOARD TO BE UNLAWFUL BECAUSE: THE TECHNICAL EVALUATION CONDUCTED BY THE IRS WAS IMPERMISSIBLY BIASED; THE SUCCESSFUL VENDOR MADE MATHEMATICAL ERRORS IN ITS PROPOSAL THAT RESULTED IN A SIGNIFICANT UNDERSTATEMENT OF ITS COSTS OF WHICH THE IRS WAS NOT AWARE; AND

THE SUCESSFUL VENDOR MISREPRESENTED THE STATUS OF CERTAIN SOFTWARE WHICH, IT TURNED OUT, DID NOT MEET FEDERAL STANDARDS. THE BOARD ORDERED THAT CONTRACT TERMINATED, AND IT GAVE THE IRS THE OPTION OF MAKING AN AWARD ON ANOTHER PROPOSAL OR SEEKING AN AMENDMENT OF THE EXISTING DELEGATION OF PROCUREMENT AUTHORITY TO ALLOW ANOTHER ROUND OF NEGOTIATIONS. THE IRS DECIDED THAT IT MUST PROCEED WITH AN IMMEDIATE CONTRACT AWARD DUE TO ITS URGENT REQUIREMENTS FOR THE EQUIPMENT. THE VENDOR WHOSE CONTRACT HAS BEEN TERMINATED HAS APPEALED TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT, THE PROPER FORUM FOR REVIEWING THE PROPRIETY OF THE BOARD'S DECISIONS.

THE COMPETITION IN CONTRACTING ACT OF 1984 ESTABLISHED THE GSA BOARD OF CONTRACT APPEALS AS AN ALTERNATIVE FORUM FOR RESOLVING PROTESTS CONCERNING ACQUISITIONS OF ADP RESOURCES. THE BOARD HAS BEEN CAREFUL TO ADHERE TO THE LAW DEVELOPED BY THE FEDERAL COURTS IN MAKING ITS RULINGS.

THE BOARD DOES NOT INITIATE THE CASES THAT COME BEFORE IT; RATHER, THE CASES THAT COME BEFORE THE BOARD ARE FILED BY VENDORS OF ADP RESOURCES WHEN THEY BELIEVE THAT A CONTRACTING AGENCY HAS ACTED UNLAWFULLY. THE COMPETITION IN CONTRACTING ACT REQUIRES THE BOARD TO ADHERE "TO THE GOALS OF ECONOMIC AND EFFICIENT PROCUREMENT," AND IT PERMITS THE BOARD TO DISMISS FRIVOLOUS OR INVALID PROTESTS. UNDOUBTEDLY, CONTRACTING AGENCIES STAND READY TO ASSIST THE BOARD IN DETERMINING WHICH PROTESTS ARE FRIVOLOUS OR INVALID.

Former Presidents

QUESTION: IT IS MY UNDERSTANDING THE REQUEST FOR THE ALLOWANCE AND OFFICE STAFF FOR FORMER PRESIDENTS' ACCOUNT HAS BEEN ADJUSTED FROM THE ORIGINAL BUDGET SUBMISSION. COULD YOU PROVIDE THOSE CHANGES AND EXPLANATION OF THEM FOR THE RECORD?

ANSWER: THE APPROPRIATION FOR ALLOWANCES AND OFFICE STAFF FOR FORMER PRESIDENTS PROVIDES FOR PENSIONS AND OTHER ALLOWANCES TO WHICH FORMER PRESIDENTS AND THEIR WIDOWS ARE ENTITLED UNDER LAW. THE REVISION TO THE INITIAL FY 1987 REQUEST REFLECTS A REDUCTION FROM $1,234,000 to $1,176,000. THE MAJOR PORTION OF THE REDUCTION WAS TAKEN IN TRAVEL AND TELEPHONE EXPENSES. THE REDUCTIONS RESULT FROM ACTIONS INITIATED BY THE FORMER PRESIDENTS TO CONTROL COSTS, MINIMIZE THEIR REQUIREMENTS FOR FY 1987, AND THEIR DESIRE TO DO THEIR PART TOWARD ACHIEVING GRAMM-RUDMAN- HOLLINGS REDUCTIONS.

FORMER PRESIDENTS
FY 1986 VS FY 1987
($ IN THOUSANDS)

	INITIAL FY 87 REQUEST DOLLARS	REVISED FY 87 REQUEST DOLLARS
FY 1986 AUTHORIZED BY THE CONTINUING RESOLUTION, PUBLIC LAW 99-190.	1,100	1,100
LESS GRAMM-RUDMAN-HOLLINGS..................	(35)	(35)
FY 1986 REVISED..............................	1,065	1,065
FY 1987 REQUEST..............................	1,234	1,176
CHANGE FROM FY 1986	169	111
RESTORATION OF GRAMM-RUDMAN-HOLLINGS........	35	35
PROGRAM INCREASES...........................	0	0
PROGRAM DECREASES...........................	0	0

OTHER INCREASES:		
TRAVEL AND TRANSPORTATION OF THINGS.....	44	10
RENT INCREASE DUE TO PBS RATE INCREASES.	30	30
INCREASE FOR COMMUNICATIONS, UTILITIES, PRINTING, OTHER SERVICES AND SUPPLIES...	43	17
EQUIPMENT AND OTHER MISCELLANEOUS SERVICES............................	17	19
TOTAL CHANGE, FY 1986 REVISED TO FY 1987 REQUEST...........................	169	111

Federal Supply Schedule Program

QUESTION: GSA is currently the purchaser of supplies for agencies. Wouldn't it be easier and more cost effective for those agencies to use GSA schedules to determine what they want and then directly order it. Can this be done? Is it being done?

ANSWER: The Federal Supply Schedule program is in many cases the most economical method of supply, and in fact it accounts for 48 percent of the total FSS procurement. It provides an estimated savings of 15 percent and allows FSS to provide sources for commercial items which vary in features or frequently change with advance in technology. Other items, however, are more standard and the advantage of bulk buying afford enough savings, an estimated 33 percent, to offset storage and handling costs in the warehouse or retail system. Special Order high volume or large size items such as furniture or motor vehicles are more suitable for central receipt of requisitions and contracting for consolidated requirements and an overall price economy of 6 to 30 percent is achieved, depending on commodity being procured.

FSS has an econometric decision model which is used continually to evaluate the overall cost to the Government to supply an item in each of these three methods of supply. Items can be changed due to bulk, demand, price breaks, etc. As an example, several hundred construction material items are being moved from the stock program to Federal Supply Schedule this year. The model also estimates costs to the customer agency; it can take more time and a higher level employee to select an item and issue a purchase order from a schedule than is required to fill out a requisition for a stocked item such as pencils. These assumptions are among the factors which will be evaluated in a Cost Comparison Study. A contract was recently awarded for this study to review costs to the Government for open market (local) purchases as well as ordering through the various FSS programs.

Self-Service Stores

QUESTION: You have closed the self-service supply stores. How has this worked in favor of using supply depots. How has this worked? Will the closure of the depots in FY 1987 hinder this program?

ANSWER: During FY 1985 FSS successfully accomplished the major undertaking of closing 45 self-service stores, 5 of which are concurrently converted to Customer Supply Centers. Closure of the self-service stores did not impact the

Wholesale Distribution Centers, since customers previously supported by these self-service stores are now provided supply support through our CSC program.

The overall nationwide response to the Customer Supply Center program has been very positive. We have provided the Federal workforce with the most convenient method of retail supply support; customer orders can be placed by telephone eliminating paperwork, and are delivered to the customer workplace by means of small parcel carrier eliminating time and travel away from the worksite. Customers in remote locations who previously were unable to utilize the self-service stores can now receive supply support service from the CSC's.

We do not anticipate any adverse impact on the CSC program as a result of planned Wholesale Distribution Center closures.

Equipment Purchases

Question: Equipment is to be directly purchased through appropriations and revolving funds in FY 1987. Could you explain how this differs from current procedures and what the advantages to this change are?

Answer: Up through FY 1986, most of GSA's administrative and operating equipment had been purchased centrally through a revolving fund and then the various users of the equipment were charged annually the cost of the depreciation. In July, 1984, GAO ruled that the General Supply Fund should not be used to provide multi-year financing for other users' equipment. Recognizing the lead time required in the budget process, GSA, GAO, and OMB agreed that FY 1987 would be the appropriate time to convert to the new system. Starting in FY 1987, all equipment users will fully fund and expense out their total equipment requirement annually in the various accounts throughout GSA. That way, you can see in every purchasing account exactly what the total equipment requirements are every year. Also, there is less bookkeeping required since one account will not be billing and collecting from other accounts. Even though we had used the old system for 20 years, we believe this is a more straightforward way of budgeting for equipment in GSA.

Stockpile Transaction Fund

Question: No funding limitation is being requested for the stockpile. Where are we today? Have we come up with a comprehensive stockpile plan?

Answer: The FY 1987 budget reflects $30 million for the purchase of stockpile goal material, which is consistent with the President's July 8, 1985, proposal to modernize the stockpile. There are sufficient funds and obligational authority in the Stockpile Transaction Fund to support this activity. At this time a comprehensive plan (the Annual Materials Plan) for restructuring the National Defense Stockpile is being prepared by the Federal Emergency Management Agency (FEMA).

QUESTIONS SUBMITTED BY SENATOR MATTINGLY

QUESTION:

Your agency is requesting $1 million to combat potential waste and fraud. Could you give me some specifics on how you plan to accomplish this?

ANSWER:

Our requested FY 1987 funding of $21,108,000 ($1,153,000 above the FY 1986 level) and a staffing level of 417 would provide considerable benefit to the Government. This increased funding would provide for 29 FTE above our original fundable FY 1986 level and 46 FTE over our current on board strength of 371. The importance of each additional FTE cannot be overemphasized. Available productivity data tell us that for each additional FTE, we can obtain, on average, cost recoveries/avoidances of over $444,000. This translates to a return of $10 for every dollar budgeted for OIG salaries.

Allocation of the 46 FTE to the Office of Audits would directly result in 124 additional preaward and postaward audits of contracts and about 30 more internal reviews. This increased production should translate to an additional $27.7 million in recommended cost avoidances and recoveries, bringing our projected FY 1987 total to $168 million. Allocating the additional funding to our audit effort would still enable us to maintain our current investigative staffing and productivity levels.

QUESTIONS SUBMITTED BY SENATOR DECONCINI

QUESTION: Your budget for rental of space increases by $49.8 million over fiscal year 1986 levels -- from $885.3 million to $935.1 million in 1987. This represents a net increase over last year's level, with certain reductions made in current programs to offset, in part, the increases required next year, as I understand your justifications.

Of the net increase, $27,725,000 will be required to cover the costs of 2,416,000 square feet of new agency expansion space to be leased in 1987. GSA has been on a crusade during this Administration to try to get government agencies out of leased space and into Government owned space that is much, much cheaper.

What would be the effect on your ability to house Government agencies in this new leased space if we were to deny this increase and say, instead, that you should house them in Government owned space? Could that be accomplished next year and, if so, what would the savings be?

ANSWER: Expansion space is required to house activities that are funded and authorized through the Congressional appropriations process. New leased space is required because of the unavailability of suitable Government-owned space. A denial of funds for new leased space would make it impossible to house these expansion requirements.

QUESTION: Your square foot-per employee level will be 155 square feet per person housed in leased space next year -- down slightly below 1986 levels.

What specific steps are you taking and will you take next year to bring that figure and your per-person square foot rate for Government owned space, down to the 135 square foot standard that everyone is aiming for? Be specific.

ANSWER: On March 17, 1986, the Administrator, GSA, approved the goals and policy framework for a new space reduction initiative.

The objective of this program is to reduce the GSA leased space and total space inventory while improving the quality of the work environment to enhance morale and productivity.

This program will be an extension of current efforts under FPMR Temporary Regulation D-71, Work Space Management Reform. However, the new approach will use innovative concepts and techniques to encourage agencies to move into more efficient, less costly space. These may include provisions for time financed space alterations, time financed acquisition of furniture systems, free space planning/space programming services, and delayed RENT increases when agencies increase their utilization efficiency and reduce the Government's space costs. GSA will continue to work with OMB in reviewing agency budgets and space plans. Increased emphasis will be placed on reducing agency space commensurate with personnel reductions.

Interagency Fleet Management System, General Supply Fund

QUESTION: Mr. Golden, I notice that you are requesting an increase of $7.8 million under General Supply Fund, for Federal Fleet Operations.

Your justifications are a bit vague as to why you need this additional money to conduct your Fleet management operations in fiscal year 1987.

Could you tell the Committee why you need this additional money for Fleet operations next year and tell us how your management initiatives fit in with those motor vehicle fleet initiatives that are in the Reconciliation bill that could be signed into law before the end of this month? Could you tell us what steps your agency is prepared to take to implement the directives contained in the Reconciliation conference report when it becomes law?

ANSWER: The increase of $7.8 million from fiscal year 1986 to fiscal year 1987 is the result of general increases in expenditures due to fleet consolidation of other agency vehicles. Approximately 7,000 vehicles will be consolidated into the GSA Federal Fleet in fiscal year 1987. This is an increase in the level of activity through the revolving fund and not a request for appropriations.

An aggressive restructuring and modernization program was undertaken for the GSA Interagency Fleet Management System (IFMS). First year savings were $6 million by reducing FTE levels from 1,300 to 860; combining 96 motor pools into 56 Fleet Management Centers; and automating and centralizing maintenance control. Other management information system (MIS) improvements were designed and are in the implementation stages.

The GSA fleet MIS has been based upon standards that will be required under the Governmentwide MIS, as prescribed in the Reconciliation bill. The system ultimately will be available for use by other Federal agencies as the means to capture, account for, and report fleet operating cost data required by the bill. In the interim, data reported by the agencies to GSA for the annual Federal Motor Vehicle Fleet Report (FMVFR) can serve as the base line for reporting requirements under the bill. Data on privately-owned vehicle use and leased vehicle operating costs are not currently collected; agencies will be required to compile and report such under the bill.

GSA will provide agencies actual and estimated IFMS cost data for inclusion in their detailed feasibility studies of support alternatives, as required by the bill. The agencies current cost of operation will be based upon the cost standards that have been included in the GSA MIS. Cost of contract alternatives will be explored by the preparing agencies. Once the studies are completed, GSA will review for adherence to appropriate cost accounting standards and to determine whether consolidation with the GSA/IFMS will be advantageous. On the basis of agency studies, GSA will report to Congress consolidation opportunities.

GSA will issue regulations, standards, and definitions to assure agency compliance with the provisions of the bill. Reduction goals will be established by the Director, OMB, and compliance will be monitored by the Comptroller General.

GRAMM-RUDMAN-HOLLINGS RESTORATIONS

QUESTION:

Mr. Golden, just yesterday, I noted that the Treasury Department is requesting full restoration of the so-called Gramm-Rudman March 1st sequester cuts in its fiscal year 1987 budgets for all but four Treasury accounts. The total amount of the restoration would be $236.7 million. I felt that this was a circumvention of the Gramm-Rudman-Hollings bill, or at least its intent, and I still do.

I could not find any evidence that your agency had specifically built the Gramm-Rudman-Hollings sequester cuts back into your FY 1987 base for the accounts and programs within GSA.

Could you corroborate this, or tell us where you have actually restored the Gramm-Rudman sequester of March 1st -- in total or in part -- to specific GSA accounts?

ANSWER:

1986 Gramm-Rudman-Hollings (G-R-H) cuts are not reflected in GSA's 1987 budget. This is not actually a restoration, but a case where sequestering has reduced the 1986 base, and does not circumvent the intent of the bill.

G-R-H has only one basic intent, and that is to reduce the level of total Federal expenditures. In formulating a budget, this is accomplished by the executive branch and Congress through a logical process of reviewing program priorities and costs. The President's 1987 budget reflected an overall program that met the $144 billion G-R-H 1987 outlay target. If sequestering is triggered during budget execution, however, reductions are automatically and uniformly applied without regard to program content, priorities, or relationships, and achieving them may require one-time or other actions totally unrelated to budget requirements.

As a case in point, GSA's requested 1987 appropriations are $12.4 million below amounts enacted for 1986, supporting certain necessary program increases, offset by savings from a number of productivity improvements, management efficiencies, and other initiatives. This did not change when 1986 was reduced $17.9 million by sequestering, although the 1987 budget suddenly became an "increase" of $5.5 million.

We are meeting the 1986 reductions by accelerating many of the organizational and cost savings initiatives planned for 1987, by restraining or eliminating discretionary costs wherever possible, and by asking the Committee's approval to reprogram certain 1986 funds to ameliorate impact of the $17.9 million reduction. If these measures fall short, we may also have to furlough employees to make up the difference. None of these actions directly affects the 1987 budget. Although I hope that implementing streamlining proposals early may result in some further 1987 savings, it is simply too early to tell.

GMA: Recompetition of teleprocessing services contract

QUESTION:

You are requesting $6.3 million next year in order to recompete the contract currently awarded to Computer Science Corporation for teleprocessing services for the so-called NEAR system. This would be a one-shot deal and supposedly have great payoff in the outyears. Can you explain to the Committee why it will cost $6.3 million to recompete this contract?

ANSWER:

The term "recompete" is used to represent all activities which will result in the transfer of the current accounting system (NEAR) software to a new host teleprocessing system. The current Computer Science Corporation (CSC) contract for these services expires in March 1988. These activities can be grouped into three steps:

1. Procurement activities - These lead to the award of a new contract.
2. Conversion activities - These are the first actions under the new contract. They result in revised but functionally equivalent accounting software which will run on the new teleprocessing system.
3. Operational activities - These begin with system acceptance activities and continue through the life of the contract.

The $6.3 million requested is necessary to pay for activities in the second step, after contract award.

The contractor will be required to convert the NEAR programs and files to functionally equivalent software which will run on the new teleprocessing system. This is expected to be done during the first 12 to 18 months of the contract, which will be concurrent with the last 12 to 18 months of the current contract. In addition, the contractor is required to train GSA personnel in the use of the system and provide resources and support for testing of converted software and data.

The vast majority of the $6.3 million requested is based on an estimate of the software conversion charges obtained from a study performed specifically for that purpose. The actual cost of conversion may be more or less depending on competition in the market. The remainder is for training, testing, communications, manuals, tape conversion and like activities involving preparation to become operational on the new host system.

Conversion activities and their associated costs are both necessary and unavoidable whenever application systems like NEAR must be transported from one host system to another. Since our current contract is expiring, we have no choice other than to include these activities in our planning and our funding requests.

None of the $6.3 million was requested to support the procurement activities in the first step or the operational activities in the third step.

IRMS, ADP Fund, Federal Data Processing Centers

QUESTION:

Your justifications indicate that obligations for the Federal Data Processing Centers have jumped rather dramatically. They have increased from $18.2 million and 84 workyears in FY 1985 to $77.2 million and 173 workyears in 1986 to $100.5 million and 173 workyears next year. Why this huge jump in obligations for Federal Data Processing Centers?

ANSWER:

Obligations for the Federal Data Processing Center(FDPC's) result strictly from requests for support from other Government Agencies. All support is provided on a reimbursible basis and most is provided through commercial contracts managed by the FDPC's. Projected amounts are based on information from customer agencies and historical data. Most of the dollar increases are for contractor support to supplement the in-house staff efforts of the Office of Software Development and Technology. Since all activities are reimbursable, if work does not materialize obligations will not be recorded.

The increase in workyears is a direct result of the transfer of the Federal Computer Performance Evaluation and Simulation Center from the Air Force to GSA at the beginning of FY 1986. 93 FTE were transferred with this activity.

Travel: Agencywide increase, FY 1985 vs. 1987

QUESTION:

Your summary table on page 17 of your justifications shows that travel and transportation of persons among the general and special funds activities at GSA has increased by nearly 40% between FY 1985 and 1987. Why have your travel expenses increased so dramatically during this timeframe? After all, GSA employment has been dropping and airfares have dropped dramatically over the past three years.

ANSWER:

In the Federal Supply Service, the increase in travel reflects current oversight and supervising requirements based on extensive restructuring of organizations and consolidation of field activities. The travel increase is offset many times over from streamlining to more efficient organizations with fewer people. In General Management and Administration, the increase is due to the consolidation of regional and CO Finance activities into Kansas City and Fort Worth, resulting in relocation of employees as well as a need for managers and working-level employees to travel to insure timely implementation, training, etc. In the Inspector General's office, the increase in travel provides increased emphasis associated with the audit and investigation of GSA activities and contracts awarded by GSA. There were also increases due to inflation.

Other Services, FY 1985 vs. 1987

QUESTION:

Your "other services" budget object classification has also shown rather dramatic growth since FY 1985-- increasing over 44% during that time.

What has been the principle reason for that large percentage increase in other services among your appropriated accounts?

ANSWER:

In General Management and Administration, the increase from 1985 to 1987 includes $6,000,000 for recompetititon of the teleprocessing services contract for the accounting and payroll system, $2,000,000 for the automated acquisition system, and inflation. In most accounts, it reflects the trend to contract out our functions rather than perform them in-house as a result of A-76 studies. There is a corresponding offsetting decrease in salaries and benefits as a result of fewer Federal employees.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

My questions pertain to the Columbus, New Mexico border facility. This border station, located 500 feet from the international boundary with Mexico, covers 1800 square feet and is constructed of concrete block. It has a small canopy over a one-vehicle inspection lane, no secondary vehicle inspection area to speak of, and no commercial import inspection facility. Last year, 279,193 vehicles, 829,743 persons, and 102,353 head of cattle passed through the Columbus Port of Entry. Everyone who has studied this facility, including GSA agrees that this facility, which was constructed in 1955, is too small, functionally obsolete, and too far from the border.

Pursuant to report language in last year's appropriation bill, GSA submitted a prospectus on the reconstruction of the Columbus border station to Congress. This prospectus requests the funds and authority to build a facility consisting of 6,800 square feet of office space, a canopy over two vehicle primary inspection lanes and six secondary inspection spaces, and a 700 square foot dock capable of parking four commercial vehicles and located inside a fenced and lighted import dock. The design will be based upon the approved generic plan for border stations. The President has requested $2,680,000 for the reconstruction of this border station in his FY 87 budget.

I recognize that GSA agrees with me that this project is vitally needed. I am concerned, however, that the timetable for this project is much too lengthy. Although the Architectural and engineering Contract procurement is set to begin next month, design work will not start until next February and will not be completed until February of 1988. Construction is scheduled to begin in July 1988 and is not slated for completion until July of 1990. That is over four years from start to finish of the project. It seems to me to be an inordinately long period of time.

QUESTION: My first question is why will it take one year to design this facility which is to be based upon a pre-existing generic design?

ANSWER: The generic border station design program developed by the General Services Administration (GSA) consists of a set of standards and/or guidelines, and will be used by the contracted Architecture and Engineering (A/E) firm in the design of the Columbus, New Mexico border station facility. We do not have a preexisting generic plan ready for use.

The project schedule, as stated in the prospectus, was based on past history of time schedules required for construction proposals requiring Congressional approval and appropriation. Since we believe that this project will receive favorable consideration, preliminary design work for the border station facility is underway. We plan to contract with an A/E when the project funds become available, as soon after October 1, 1986, as possible. We are allocating only seven months after that date for design work by the A/E. The estimated design completion date for this project is July 1, 1987.

QUESTION: How come GSA has estimated that it will take two years to construct this small facility?

ANSWER: Due to Federal procurement regulations, we are allocating four months for the solicitation and award of a construction contract and anticipate 12 months for actual construction. Project completion is scheduled for November 1, 1988.

QUESTION: It has been suggested that GSA just use the facility plan for the Presidio, Texas border station. Has GSA contemplated this alternative?

ANSWER: The Presidio and Columbus facility requirements and site vary enough to warrant design specifically for Columbus.

QUESTION: Traffic through Columbus increases each year. It can be anticipated that additional inspection areas will be needed in the future. With that in mind, why does the prospectus recommend only two primary inspection lanes? Would it not be preferable to make room for four inspection lanes, so that the inspection area can be expanded when the need arises?

ANSWER: The present plan provides for expansion of the vehicle facility. When lane expansion need occurs, it can be done without time consuming site purchase, and would be accomplished through the GSA minor projects budget.

NATIONAL ARCHIVES AND RECORDS ADMINISTRATION

STATEMENT OF FRANK G. BURKE, ACTING ARCHIVIST OF THE UNITED STATES

ACCOMPANIED BY CLAUDINE J. WEIHER, ACTING DEPUTY ARCHIVIST OF THE UNITED STATES

INTRODUCTION OF ASSOCIATE

Senator ABDNOR. Next we are going to hear from Mr. Frank Burke, the Acting Archivist of the United States. Mr. Burke and colleagues, we welcome you to the committee, and we will turn it over to you. Your entire statement will be made a part of the record so you may proceed in any fashion you may desire.

FISCAL YEAR 1986 BUDGET

Dr. BURKE. Thank you, Mr. Chairman. I am Frank Burke, the Acting Archivist of the United States, and with me today—we are a small agency so I only brought one person—is Claudine Weiher, the Acting Deputy Archivist. I have submitted a statement for the record that explains the changes compared with the amount enacted in the continuing resolution. Our budget is complicated by two major factors. One is the carryover money from prior years which amounts to $7,569,000. The other factor is the Gramm-Rudman-Hollings reduction of $4,359,000 that is not specifically identified in the budget.

So I would like to attempt briefly to explain the numbers in the budget as clearly as I can to help us then focus on a few of the programmatic issues that we have been concerned with. The Congress appropriated, as you are aware, in the continuing resolution $101,363,000 for the National Archives and Records Administration.

Gramm-Rudman-Hollings reduced it by $4,359,000, of which $172,000 came out of the grant program. That leaves us, therefore, with the 1986 figure of $97,004,000 for archives programs this year, including $3,828,000 for grants.

FISCAL YEAR 1987 BUDGET

Our 1987 request of $101,321,000 restores this one time Gramm-Rudman-Hollings cut. It also provides for the following increases: $2,316,000 in space related costs which includes rent increases and small amounts of expansion space totaling $1,035,000, and operations and maintenance funds for the Carter Library which will be opening this year, and other minor operations and maintenance and recurring reimbursables for $1,281,000.

It also includes preservation funds of $415,000, program costs for the new Carter Library of $600,000, and $1,239,000 for increased costs of goods and services. These increases of $4,570,000 are offset by decreases of $4,612,000, $4 million of which is from the grants program, for a net reduction from 1986 to 1987 of $42,000.

Again, this summary excludes the carryover funds from fiscal year 1986. What this budget really represents is a restoration of the one-time cuts which we are still trying to accommodate with a minimal impact on our programs and personnel, plus the necessary increases to maintain our facilities, to open the Carter Library, and to continue our implementation of the preservation program.

In essence, these necessary program increases are being offset by elimination of the grant funding. In spite of the Gramm-Rudman-Hollings reductions and the essentially stable funding level in 1987, we are implementing some initiatives begun in 1984 and 1985. In 2 weeks, we will be celebrating our first anniversary as an independent agency, the National Archives and Records Administration.

INDEPENDENCE

During the past 12 months we have concentrated on a number of areas. One, and the one for which Ms. Weiher is most responsible for the success of, is the transition from being a service within GSA to being an independent agency. It is something that I would suggest every agency go through about every 10 years but no more often than that. It made us look at everything that we are doing, rewrite all of our manuals, all of our procedures, look at all of our forms, redefine all of our purposes and goals, reinventory all of our furniture and equipment, and essentially bring everything up on the table and look at it and redo it.

Senator ABDNOR. That must have taken most of the first year?

Dr. BURKE. Actually it was accomplished in a little over 4 months, and I think that as a result of that we have, in effect, a fresh agency although it is 50 years old, since the National Archives was first established in 1934.

Senator ABDNOR. Are you quite pleased with the separation, standing on your own, and no regrets about it?

Dr. BURKE. We are. No; do you have any regrets?

Ms. WEIHER. No.

Dr. BURKE. No; we have no regrets about it. I think that we are now able to pursue the practices necessary to serve our constituency, to set our own priorities, and to expend our funds in the manner that we think is most appropriate for what those priorities are.

So the transition is complete, and as a result of having rewritten all of our manuals, procedures, and looked at all of our forms and redone them and thrown a lot of them out, and a number of other things, I think that when the President does appoint an archivist, which I would hope would be soon, that that archivist will come into one of the best managed agencies in the Government, if only because everything is so fresh and new, and yet based on a long tradition, and a history of the agency.

PRESERVATION

We have been able in the last year to continue our program to advance the preservation of the documents within the National Archives in our facilities from coast to coast, some 30 facilities around the country including the presidential libraries, the 11 branch Archives, the facilities here in Washington, and our record centers.

Preservation is a big task. Paper is biodegradable, and we have to watch out that it does not do it when we are not looking, and we have been moving forward with maintenance programs to continue the preservation of the material, so that the historic records will be available for future generations. One of the things that we have done, and we will soon be implementing, is work with NASA and the Jet Propulsion Laboratory to develop a micrometric computerized system for analyzing the condition of the Declaration of Independence, the Constitution, and the Bill of Rights so that we can tell immediately if any changes are taking place in the physical characteristics of those documents.

The equipment which is highly computerized and based on space age technology will also be applicable to any other documents in the National Archives or those in any other facilities such as the libraries around Washington which may want to use it.

COMPUTER NETWORK

We have moved forward into another aspect of automation to the point that we now have almost totally computerized our operation from coast to coast. We are beginning a linkage network and I hope it will not be long before any researcher can walk into any of 30 facilities around the country, ask a question, have the archivist there go to the computer and find out where the material is, whether it is in the Truman Library in Independence, MO, or in the Boston field archives or in the National Archives in Washington, and assist the researcher.

At the present time we are using that computer network as an administrative tool, as an office automation activity, and linking ourselves nationwide through electronic mail, and the computer network that we have.

CHANGES DUE TO INDEPENDENCE

We are also in that regard what I would call nationalizing the National Archives. When we left GSA, we decided that the middle level regional structure was not necessary for such a small operation as ours, and we have made the field archives and Federal records centers as well as the presidential libraries report directly to Washington with no middle level intervention.

The mid-level intervention of regional structure was always a hindrance to our operation, we felt, and this makes the new agency structure a lot cleaner and more direct. It may require a little more travel on the part of the Washington people to go out to do oversight, but that drawback is offset by the breaking down of bureaucratic structure that separated the central office from the field offices. We have improved our communication both internally and externally. Internally, through the computerized network and more contact between the administrative and the program staffs.

We have moved from a bureaucratic to a collegial type agency where we discuss mutual problems among professionals and then come to conclusions, which can then be implemented. Externally, we have established better and closer relations with other agencies, with the agency records officers, with the agency historical officers, and also with the constituencies that use the archives, genealogical, historical, legal and so on.

NATIONAL HISTORICAL PUBLICATIONS AND RECORDS COMMISSION

Finally, we have in the last year carried forward the programs of the National Historical Publications and Records Commission and have seen rather a banner year. There were within the past few months three more volumes published, now making six volumes of the "Documentary History of the First Federal Congress;" two volumes of the "Documentary History of the First Decade of the Supreme Court;" the second volume of a series called "Freedom," a "Documentary History of Emancipation," based on the Freedmen's Bureau records in the National Archives; a volume of the "Marcus Garvey" papers; a volume of the "Jefferson Davis" papers; and in the other side of the program, a major study on the condition of records in the State archives.

PREPARED STATEMENT

So that is what we have been doing for the first 11 months of our independence. We look forward to carrying on minimally with those activities in the next year with the budgetary constraints that are imposed upon all of us. That is the end of my statement. Mr. Chairman, I am ready to respond to any questions that you may have.

[The statement follows:]

STATEMENT OF FRANK G. BURKE

I am Frank Burke, Acting Archivist of the United States. I have with me today Claudine Weiher, Acting Deputy Archivist, and James Megronigle, Acting Assistant Archivist for Management and Administration.

I appreciate the opportunity to appear before you to present the proposed 1987 budget for the National Archives and Records Administration (NARA). As you know, this agency was established on April 1, 1985, by enactment of the National Archives and Records Administration Act of 1984 (Public Law 98-497) on October 19, 1984. This account assumed all of the liabilities, obligations and commitments of the General Services Administration's Operating Expenses, National Archives and Records Service account plus the existing National Archives Trust Fund and Gift Fund and acquired funding from the General Services Administration to support certain administrative activities.

The transition to an independent agency was accomplished smoothly and with no operational disruption. As a result of independence and subsequent elimination of regional overhead, the Archives has reduced duplicative support services and improved overall management control of these functions. In the interest of economy, we continue to use GSA's payroll and accounting services on a reimbursable basis.

NARA's continuing primary function is to preserve the Nation's cultural heritage by preserving and making available the documentary record of our national government, and to carry out our related responsibilities for the management, appraisal, and disposition of all Federal records and for the preservation, description, arrangement and availability of those of permanent value. Throughout the country in 11 field Archives Branches, and here in the National Archives building in Washington, we carry out these archival functions and make the Nation's records of enduring value available for research by the Federal Government, scholars, and the general public.

We administer the system of Presidential Libraries where papers and historical materials of American Presidents, and the papers of their associates, are preserved and made available for research. Each year a large number of visitors view significant historical materials displayed in major exhibits in the Presidential Libraries. In addition, Presidential materials are administered pending the establishment of Presidential Libraries.

NARA operates a system of 14 Federal records centers where non-current Federal records are stored and serviced economically for Federal agencies until eligible for disposal or transfer to the National Archives. Each year this program results in substantial cost savings for the Government by removing records from expensive agency office space to low cost storage space provided by the center system, and by carrying out an active and effective records disposition program.

NARA is responsible for publishing administrative regulations, the laws, and Presidential documents, in the Federal Register and related publications. We make available to the general public all of the significant rule-making of the Executive Branch.

Another of our important activities is the National Historical Publications and Records Commission. Although Public Law 98-189 reauthorized the Commission from 1984 to 1988, including authorization of $4,000,000 in 1984 and 1985, and $5,000,000 in each of the succeeding three years, grant funds are not being requested for FY 1987. In FY 1987, the Commission will continue in its advisory capacity coordinating and making recommendations on high priority publications and records projects and actively seeking private support for the program.

NARA also reviews for declassification security classified permanently valuable records and historical materials in accordance with E.O. 12356.

Changes from FY 1986

Our FY 1987 request of $101,321,000 for Direct Operating Expenses is a total decrease of $7,611,000 from the FY 1986 budget level. However $7,569,000 of this decrease is made up of funds carried forward from prior years, specifically $5,200,000 carried over from 1985 for improvements to the Kennedy Library, $2,000,000 for the FY 1982 supplemental, $264,000 for preservation of House and Senate records and $105,000 in grants program funds. The actual change from 1986 to 1987 is a decrease of $42,000. This change includes increases of $415,000 for preservation, $600,000 for the Carter Library, $36,000 for recurring reimbursable payments to the Federal Buildings Fund (FBF), $1,239,000 for the increased cost of goods and services, $1,245,000 for operation and maintenance costs for the National Archives building and Presidential Libraries, and $1,035,000 for payments to the FBF for RENT changes. These increases are offset by reductions of $4,000,000 for Grants, $112,000 for A-76 initiatives, $300,000 for productivity improvements, and $200,000 for repairs and alterations for the Archives building.

Preservation

Preservation of our Nation's documentary heritage continues to be of the highest priority to NARA. Our preservation workload is determined by the quantity and condition of archival records. Many archival records require treatment in order to preserve them for future use. At our request, the National Bureau of Standards assisted NARA in identifying immediate and long range preservation needs that require action over an extended period. Based on this, NARA prepared a 20-year preservation plan, which prescribes a systematic course of action to alleviate the current preservation backlog and to preclude the creation of any new workload. Our 1987 budget includes $7,000,000 for preservation, an increase of $415,000 above the basic program to implement the second year of the 20-year preservation plan.

Summary

Except for the increase in the preservation program, funds for the Carter Library and no funding requested for the Grants program, this budget is basically a continuation of programs at the FY 1986 level and is intended to enable us to carry out our basic mission. It represents our assessment of resources necessary to continue the ongoing programs which are our mandated responsibilities.

Thank you for the opportunity to make this brief statement, Mr. Chairman. I will be pleased to respond to your questions.

BIOGRAPHICAL SKETCH OF FRANK G. BURKE

Personal Data - Born April 22, 1927, New York, New York; current residence: 3401 Charleson Street, Annandale, VA 22003; married.

Education - Ph.D. 1969, University of Chicago
M.A. 1959, University of Chicago
Student 1953-55, University of Alaska

Professional Experience - Acting Archivist/Deputy Archivist of the United States, 1985-
Acting Assistant Archivist for the Office of the National Archives, 1984-1985
Executive Director, National Historical Publications and Records Commission (NARA), 1975-1984
Assistant to the Archivist of the United States, 1974-1975
Director of Educational Programs (NARA), 1968-1974
Information Retrieval Specialist (NARA), 1967-1968
Manuscript Division, Library of Congress, 1964-1967
Department of Special Collections, University of Chicago, 1962-1964

Professional Societies/ Awards - Fellow, Society of American Archivists
Member, American Historical Association
Member, Association for Documentary Editing
Member, Society for History in the Federal Government
Member, Manuscript Society

GRAMM-RUDMAN-HOLLINGS REDUCTIONS

Senator ABDNOR. Thank you, Mr. Burke. We always ask this question of almost all our people. Tell us how you implemented the reductions caused as a result of the Gramm-Rudman? I think you said it cost you over $4 million.

Dr. BURKE. Yes.

Senator ABDNOR. Did ycu RIF people? Did you lay off people?

Dr. BURKE. It has been very painful in a sense, although we have not suffered to the point where we have had to RIF anybody yet. Obviously, $172,000 of that reduction came from the grants program. The rest of it was tightening of the belt and hoping to make it through without great disruption of our programs. I might add that we are handling this reduction in a manner that reflects just a single year reduction rather than a long-term reduction. Therefore, we have not planned on RIF's, but rather have frozen all recruitments. We have frozen all discretionary promotions. We have eliminated all relocation costs which is difficult in an agency that has facilities from coast to coast.

We have greatly reduced training. We are leaving key positions vacant. There are at the present time an Acting Archivist and an Acting Deputy Archivist. We have five other key positions in which the people are only acting in the position until there is an opportunity later on to fill them.

We have greatly reduced expenditures for repairs and alterations to the libraries and to the Archives building although it is now 50 years old. We have postponed all repairs except emergency ones until next year. We have eliminated all acquisition of new administrative equipment, and we have extremely tight control over all discretionary expenditures. We have had to eliminate the planned $1 million preservation increase that was enacted in fiscal year 1986 in the continuing resolution, and we still do not know if more drastic measures such as furloughs might be required.

Let me say that this is not the way we would handle a long-term reduction. To do so, we would need to substantially reduce the staff, probably curtail the research room hours at all of our facilities, not just here in Washington, and begin looking toward the elimination of some programs. We have not approached the reduction this way. Nor have we chosen to cut public services first.

My feeling is that that should be the last thing to occur. Because the administration allowed our 1987 request to stand while other programs were reduced to meet the deficit targets, we have chosen to shrink all nonpersonnel costs and nonpublic services drastically, hoping to get through 1986 with a minimum of serious disruption.

CARTER LIBRARY

Senator ABDNOR. Thank you. I was going to ask you for more detail, but that is pretty detailed. I do not think we need any further information. Increased resources are being requested for the Carter Library. Would you tell the committee what the current status of the library is?

You have touched on it. What is the estimated time to get it fully operational and what is the estimated cost once the library is fully operational?

Dr. BURKE. The current status is that it is under construction. They are closing it in this month, I believe, so that all security can be put in, and the exhibits will start to be put into the building this month. We anticipate that the staff will be moving in late this summer, then we will be starting to move records in that are now stored off-site. Documentary materials, for the most part, have been stored in other parts of Atlanta where we have staff that have been working on them. We will probably open in the fall of this year.

The $600,000 that is in the budget for the opening is to increase the staff to allow us to keep the building secure and to get up to full operation, as well as to install shelving, equipment, supplies, telecommunications, and so on.

As you know, the building itself and the exhibits are not paid for by the Government, but they will be turned over to us. At that point, then, we go into annual operation which will cost approximately $1,200,000. This $600,000 is, in effect, a one-time expenditure except for those staff costs of $200,000.

Senator ABDNOR. But $1.2 million——

Dr. BURKE. That is the new staff.

Ms. WEIHER. The new staff. And there is about $400,000 now devoted to the program. The total cost when it gets up and running will be about $1.5 million.

Dr. BURKE. About $1.5 million total.

Senator ABDNOR. How big is the building?

Dr. BURKE. 70,000 square feet.

GRANTS

Senator ABDNOR. There is no money being requested for the grant program. Now, last year $4 million was provided. How much of that money has been allocated? Did all of it get allocated?

Dr. BURKE. Most of it has been allocated. There is one more Commission meeting this year, and at that Commission meeting which will take place before the end of the fiscal year—I believe it is in June—there will be an allocation by the Commission for grant applications that have been received at that time, and it is anticipated since the applications far exceed the amount of funds available that the grants will be completely expended by the end of the fiscal year.

Senator ABDNOR. Will the grants stay pretty stable? I mean the numbers you can expect, or are some years a lot higher?

Dr. BURKE. They have been fairly stable at approximately 300 applications a year. This is somewhat self-controlling because people know what the funds available are which have been stable for the last 10 years, and also the Commission advertises the priorities of what it is looking for in the grants program. So it is about 300 applications a year, Senator.

Senator ABDNOR. I understand you are thinking about securing private donations to fund the grants. Is this a practical idea? Do you think it will go over?

Dr. BURKE. We have been attempting to secure funding for the grant program for the past 5 to 6 years. We have had some success; $3 million was given by the Mellon Foundation and the Pew Foundation 5 years ago to the Founding Fathers which is the Jefferson, Franklin, Adams, Washington, and Madison papers.

That was a one-time grant from each of those foundations. There have been other funds given by the Rockefeller and the Ford Foundations, some $300,000 each, to the projects relating to black history and relating to woman's history.

There have been small grants by such organizations as the Kress Foundation for the Daniel Chester French papers. There have been a number of grants of a small amount from outside. They seem to have a pattern. That is, it might be easy to get grant money from outside for Jefferson, Madison and Washington, but it is not so easy to get for Ulysses S. Grant or for James K. Polk. There does not seem to be very much money around to give to the Polk papers.

So over the past 5 or 6 years, the total outside grants have amounted to just about $4 million. That is normally the grant amount that has been provided each year by the Congress. So if you stretch that out over 5 years, it is a small part of the grants program that has been raised, and yet there is a continuing effort on the part of the staff to involve the corporate and the foundation sectors in providing funds.

RECORDS CENTERS HOLDINGS

Senator ABDNOR. Very good. The Treasury and the Defense Departments make up something like 50 percent of holdings and records centers. I would assume the majority of these records are probably tax returns and personnel records. What does it cost to store these documents? Is there anything that can be done to reduce the costs?

Dr. BURKE. On the tax returns, IRS is working on a process to reduce the amount of paper by moving into electronic filing of tax returns. We see that as being 5 to 6 years away, however, with the process that they are attempting to use, putting the tax returns on laser discs, and then keeping them electronically. They are also working on having tax returns filed by the public electronically so that one could, I suppose, go home to one's small computer in the kitchen and file your tax return and not worry about it anymore, as long as the telephone lines were working. But we see that as a small portion of the returns because it will essentially first be used by large corporate entities that file their taxes and not affect the mass of paper that we are now receiving.

We are spending approximately $1.06 per cubic foot to store the records in our records centers. It costs the agencies about $13 to store those in downtown space or in government office space so that we feel that we are providing considerable savings to them. IRS reimburses us for the storage of the tax returns. That is not part of our normal budget. The personnel records at St. Louis are continually being used, and we have storage costs there of approximately the same.

Senator ABDNOR. Do they reimburse you, too?

Dr. BURKE. No. We absorb those costs.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Thank you, Mr. Burke and Ms. Weiher. We have questions we are going to submit to you in writing, if you do not mind. Senator DeConcini would have liked to have been here, but it is easy to get involved in the other problems, too. I will be the one to submit questions and you can send them back as quickly as possible.

Dr. BURKE. We would be pleased to do so.

Senator ABDNOR. Thank you very much.

Dr. BURKE. Thank you, Mr. Chairman.

Senator ABDNOR. Congratulations on your first great year here.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

FY 1987 BUDGET REQUEST

Senator Abdnor: The FY 1987 Budget is significantly below the 1986. Would you outline the major reasons for the reduction?

Mr. Burke: The FY 1987 budget appears to be significantly below the FY 1986 level because, in 1986, NARA's budget includes $7,569,000 in funds carried forward from 1985. The carry forward funds include $5,200,000 for improvements to the Kennedy Library, $2,000,000 for the 1982 supplemental, $264,000 for preservation of House and Senate records and $105,000 in grants program funds. The FY 1987 request is actually only $42,000 less than the 1986 budget.

UNSCHEDULED RECORDS

Senator Abdnor: I note the Navy has a huge amount of space devoted to record storage, but it is not scheduled for disposal in records centers. Why is that? Are other agencies contemplating this type of action?

Mr. Burke: Of the approximately 15 million cubic feet of records stored in our records centers, only 600,000 cubic feet are unscheduled records, down from over 3 million cubic feet of unscheduled records in 1981. While Navy records represent over 40 percent of the unscheduled records in the records centers, some 245,000 cubic feet, these unscheduled records comprise less than 18 percent of the Navy records which are stored in the records centers to take advantage of lower storage costs.

The volume of unscheduled Navy records in the Federal records centers results from an outdated Navy records control schedule, which was implemented in 1961. This schedule does not include descriptions and disposition instructions for many newer series of Navy records. Since the late 1970s, NARA has been working with Navy personnel to revise the schedule and has completed appraisal of four of the schedule's thirteen chapters. This is a time consuming process and is being carried on concurrently with the appraisal of the records of all agencies of the Federal government. Implementation of each revised chapter of the Navy schedule will reduce the volume of unscheduled records in the records centers accordingly.

To our knowledge, no other agencies are contemplating storing records with no schedule for disposal. According to NARA regulations, unscheduled records cannot be transferred to records centers without specific authorization from NARA.

SPACE COSTS

Senator Abdnor: What is the average square footage costs for the Archives? What is the most expensive? The least?

Mr. Burke: The average square footage cost for the Archives is $5.20. The most expensive type of space is laboratory and clinic areas which averages $18.77 a square foot and includes areas with built-in equipment and utilities required for analysis of matter, experimentation, processing of material and the welfare of employees or the public. The least expensive space other than parking is warehouse storage space which averages $3.86 a square foot.

PRESERVATION

Senator Abdnor: Could you briefly explain the Archives Preservation Plan?

Mr. Burke: When the National Archives opened it doors in 1934, it inherited a backlog of documents needing preservation. At that time some of the documents placed in its custody were over 150 years old and had been in storage in different agencies under a variety of uncontrolled conditions. This backlog has grown as more materials and a variety of media were transferred to the National Archives.

To solve the preservation problems associated with this backlog while maintaining pace with current acquisitions is the purpose behind the preservation plan. From FY 1981 through FY 1984, the National Bureau of Standards completed three studies examining the preservation problems and options in the National Archives. Based on the NBS studies, NARA published in early FY 1985 a comprehensive twenty-year preservation plan along with the data on which the plan relied. The plan provides for the systematic preservation of current holdings as well as the new material to be accessioned each year. When the 20 years conclude in 2005 if the plan is followed, NARA will have eliminated its preservation backlog which has been growing since the establishment of the National Archives in 1934. The key elements in the plan include: maintaining proper environmental controls in records storage areas; conducting holdings maintenance, such as reboxing and refoldering, on current holdings as well as new accessions; identifying records needing preservation action prior to their use; copying on a systematic basis the rapidly deteriorating mimeographed and Thermofax documents from the 1940s and 1950s; reproducing heavily used textual records; treating with laboratory procedures the records with intrinsic value including national treasures; and copying of non-textual material.

FY 1985 was the first full year of the long range plan and 97% of the targeted funds were expended.

Senator Abdnor: Is today's pace adequate. If not, what would it cost to accelerate it?

Mr. Burke: The current pace is not in accordance with the 20 year preservation plan. The plan called for two additional increments to the preservation base of $5.5 million. Three million dollars was to be provided in FY 1986 and $2.7 million in FY 1987 bringing the annual level of expenditure to $11.2 million. This level would continue for 18 years, until 2005 when the current backlog would be eliminated.

Funds requested for FY 1986 were in accordance with the twenty year plan. Following Congressional actions which reduced NARA's budget, funds for preservation were reduced. Subsequently, Gramm-Rudman-Hollings actions reduced the FY 1986 funding for preservation still further. Thus funds for preservation are substantially less than called for in the original twenty year plan.

These reductions have had an adverse impact on the scheduled workload for holdings maintenance, laboratory conservation and preservation copying. The pace of the preservation plan as originally outlined would have been adequate but that pace has been slowed by budget constraints. To accomplish the objectives of the original plan in a timely manner, the preservation base of $11.2 million must be funded and maintained at that level. If that can be accomplished by 1988, and assuming no additional reductions are taken in FY 1987, the plan's objectives can be completed within two to three years of the original target date of 2005.

GRAMM RUDMAN HOLLINGS

Senator Abdnor: Your request for FY 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen?

Mr. Burke: NARA could not absorb this reduction for a second year without severe cutbacks in personnel and program services. As I mentioned earlier, we have handled the FY 1986 sequestration of funds as a one time reduction by eliminating nearly all funds in support of programs but leaving our basic programs, services to the public, and staffing levels intact.

Let me recap what we have done to absorb the FY 1986 reduction, explain why we have chosen to handle the reduction in this manner and further explain why we cannot sustain this reduction for a second year without substantially reducing staff. In absorbing the FY 1986 reduction, we have put off needed repairs and alterations to the Archives buildings and Presidential Libraries, frozen recruitments, leaving key positions vacant, frozen discretionary promotions, eliminated the purchase of all new administrative equipment, reduced training and reduced the grants program. We have also had to eliminate the planned $1 million increase for the preservation program.

We approached the FY 1986 reduction in this way because the Administration, recognizing the minimum level of funds needed by the Archives to carry out its basic programs, has allowed us to restore the amount of the sequestered funds to our FY 1987 budget request. If the restoration is not allowed, substantial decreases will have to be made in staffing, in services to the public, and in basic programs, including a major reduction in force.

Approximately 37% of our FY 1987 budget request is spent on fixed costs, primarily on space costs and upkeep of the buildings in our care. Another 54% is estimated for salaries and benefits with only the remaining 9% earmarked for discretionary costs. This leaves little flexibility to absorb reductions without a large cutback in personnel and a resulting major disruption of services. Since we must pay the fixed costs plus pay additional costs for increased space in the Ft. Worth and Waltham records centers, the opening of the Carter Library, inflation for goods and services and the RENT increases for existing space, we will not be able to carry out our mandated functions and will have to begin cutting back services to the public. If as in the past, NARA has to fund the grants program without a specific increase for that purpose, the resulting disruption in services will be even more drastic.

Senator Abdnor: Would it be too much to assume that if you lived with that reduction in FY 1986, you could certainly utilize that level as a base in 1987?

Mr. Burke: Yes, as discussed previously, we cannot absorb that reduction in FY 1987 without a large reduction in force.

SPACE USAGE

Senator Abdnor: Have you reached the 135 square foot goal? If not, why and what is you target date?

Mr. Burke: As of December, 1985, the Archives has reduced space to 109 square feet per person and anticipates a further reduction to 108 square feet per person by 1987.

EXECUTIVE OFFICE OF THE PRESIDENT

STATEMENT OF CHRISTOPHER HICKS, DEPUTY ASSISTANT TO THE PRESIDENT FOR ADMINISTRATION

ACCOMPANIED BY:

URSULA H. PEARSON, DIRECTOR, FINANCIAL MANAGEMENT DIVISION
RONNIE R. RASMUSSEN, BUDGET OFFICER

OPENING REMARKS

Senator ABDNOR. Our next witness will be Christopher Hicks, who is Deputy Assistant to the President for Administration. He will present testimony for the Executive Office of the President. Chris, it is a pleasure to have you here. I believe this is your first time here.

Mr. HICKS. Both John Rogers and I were here last year. Our positions overlapped somewhat.

Senator ABDNOR. You were with him. Anyway we welcome you back, then.

Mr. HICKS. Thank you.

Senator ABDNOR. I just want to say for the record that special thanks go to Ursula Pearson, Director, Financial Management Division. She shepherded this Executive Office budget for many years, and provided this subcommittee with the cooperation and assistance of the highest level. We thank you for that service and good luck to you in your retirement.

I think you have separate statements for the nine offices. Is that the way you are going to do it today?

Mr. HICKS. Yes, sir.

Senator ABDNOR. We will let you proceed in any way that you care to, Chris.

Mr. HICKS. Thank you. I would like to introduce the witnesses with me today. Of course, you know Ursula Pearson. She has not told me yet she is retiring and I hope she will not.

Senator ABDNOR. Oh, maybe we can get Ursula to stick around.

Mr. HICKS. But she keeps threatening it. So if you keep saying nice things about her, maybe we will have her back again.

Senator ABDNOR. Good.

Mr. HICKS. I would like to also introduce Ron Rasmussen who is the Budget Officer for the Office of Administration.

Senator ABDNOR. Thank you, and welcome to the committee.

Mr. HICKS. The nine accounts that are before you today are all within the Executive Office of the President. They are compensation of the President, the White House Office, Office of Administration, Special Assistance to the President, Council of Economic Advisers, Office of

Policy Development, National Security Council, National Critical Materials Council—a new one—and Unanticipated Needs. I will summarize my remarks and submit formal statements for each of those accounts for the record.

BUDGET REQUESTS

The 1987 fiscal year budget requests for these nine Executive Office of the President accounts total $54,404,000. This is an increase of $703,000, or 1.3 percent above the enacted fiscal year 1986 funding levels. It is $336,000 below fiscal year 1985. The major portion of these funds will provide for 646 full-time permanent positions which, aside from requests for 1 additional full-time permanent position and 4 other positions for the Council of Economic Advisers, remains unchanged from the current fiscal year.

The 1.3 percent requested increase is chiefly attributable to three factors. First, we are requesting partial restoration of funding for the 5-percent pay reduction that was planned for fiscal year 1986, but not enacted.

None of the accounts before you today received any restoration of that funding in their enacted fiscal year 1986 appropriations. The level of the restoration we are requesting averages about only 18 percent on an annualized basis.

Second, increased costs for utilities, primarily telephone and after-hour utilities, and third, additional funding for ADP workload placed upon the Executive Office of the President Computer Center.

In addition to the appropriated budget authority, the Office of Administration anticipates $3,004,000 in reimbursements from various EOP users for ADP systems development work.

With the exception of Compensation of the President which is exempt, each of these accounts is complying with the Gramm-Rudman-Hollings mandated reductions for fiscal year 1986. The combined Gramm-Rudman-Hollings reduction of 4.3 percent for these nine accounts is $2,299,000.

I would like to point out that the Gramm-Rudman-Hollings reductions came off a fiscal year 1986 base level that was, even before Gramm-Rudman, a 1.9-percent reduction from fiscal year 1985. As you recall, these agencies reduced their administrative overhead by 10 percent and absorbed the 5-percent pay cut for which we were seeking partial restoration.

The Gramm-Rudman-Hollings legislation had a particularly strong impact upon the Office of Administration. Due to the nature of its work, the Office of Administration last year took the largest reduction of administrative costs, $559,000, as well as the pay reduction, and then the $671,000 Gramm-Rudman-Hollings reduction. At the same time, the Automated Systems Division of OA, which provides considerable ADP work to OMB, experienced a substantial increase in activity during the short timeframe of the budget season, due to OMB's extra data gathering and reporting requirements under Gramm-Rudman-Hollings.

These new Gramm-Rudman-Hollings reporting requirements, it is expected, will place an additional burden on the Office of Administration this summer and in future years. I do believe that the requests before you demonstrate the President's commitment to have the White House and the Executive Office of the President set an example for efficient Government operation combined with prudent stewardship of our fiscal resources. Through automation and management efficiencies we have been able to provide the best possible support to the President while maintaining virtually level personnel and funding for the past several years.

In closing, I would like to offer my sincere thanks to you and this committee for its past support, and my hope that we will continue this positive working association in the future.

IMPACT OF THE GRAMM-RUDMAN-HOLLINGS LEGISLATION

Senator ABDNOR. Thank you, Mr. Hicks. We have enjoyed working with you and the White House and your people. You mentioned Gramm-Rudman-Hollings several times. Could you, for the record, give us a little more detailed accounting on how you handle this whole thing? Ursula is already writing it down, I see.

Mr. HICKS. We actually started preparing for Gramm-Rudman-Hollings over 1 year ago because we knew we were submitting budget requests that were less than 1985 levels. Consequently, we began to look for additional management efficiencies at that time. Then when Gramm-Rudman-Hollings looked like it was going to be a reality last fall, all of these accounts operated from the beginning of the fiscal year at the House passed across-the-board reduction, or 2.65 percent below what eventually became the enacted 1986 level.

This has effectively allowed us to spread out the 4.3-percent reduction over the whole year rather than having to take it all at once at the end of the year. We benefitted considerably from this action.

More specifically, the EOP agencies are all very personnel intensive. We have tried to delay hiring, leave positions open, and start new employees at lower graded salaries. We do not have a hiring freeze. I do not expect one. We are not going to have any kind of salary freeze or merit pay increase freeze as far as I can tell right now.

We have taken a hard look at our ADP work, and we have tried to begin only those initiatives this year that are absolutely necessary and we are going to defer some for the future.

We are looking at our leasing arrangements with equipment to see if lease conversions or buy-outs would be helpful. We feel at this point in time, halfway through the fiscal year, that we will be able to meet the targets without any more drastic action than that.

SLUC

Senator ABDNOR. Good luck. Sounds like a good challenge. The SLUC rate is down slightly as a percentage of Executive Office budget. Can this be attributed to the stabilization of rates or what?

Mr. HICKS. It is stable in the sense that we did not have an increase for 1987, or we do not have one yet. I think the reason that it is down as a percentage is probably due to the fact that the proposed fiscal year 1987 budget grew slightly, 1.3 percent, while several agencies reduced their actual space requirements. That accounts for the percentage reduction. The SLUC question is still open, and I would not say that rates have stabilized.

EOP EMPLOYMENT LEVELS

Senator ABDNOR. What is the current emplovment total for the Executive Office of the President?

Mr. HICKS. This year, fiscal year 1986, we have a full-time permanent ceiling of 1,491 people. For fiscal year 1987, we are proposing a full-time permanent ceiling for the Executive Office of the President, not just these accounts before you, of 1,478. We are down 13 positions 1987 over 1986.

I would just like to add that the current figures are down from the figures that this administration inherited in 1981 where the full-time permanent level was 1,786.

Senator ABDNOR. How much?

Mr. HICKS. 1,786. So we are down in FTP count by over 300 positions, or about 18 percent.

OA SERVICES

Senator ABDNOR. Very good. The Office of Administration provides service for the other offices and the Executive Office. Funding levels have remained relatively constant, yet demands on the office for support have grown rapidly. Are you able to meet these demands, or will service delays become a problem?

Mr. HICKS. Service delays have not been a problem, and I think the funding that we are requesting for 1987 will allow us to continue current services and take on a few new initiatives. As the previous witness indicated, we are treating the Gramm-Rudman reductions as a one time factor and not long-term. If it were a long-term factor, we would have to readjust some of the services we provide. We have not had any reduction of services or delays. As a matter of fact, the additional workload that we took on for Gramm-Rudman-Hollings is a good example, I think, of our ability to take on unexpected additional work in stride without causing delays elsewhere. But our 1987 funding should be adequate.

Senator ABDNOR. I hope that not too many of our agencies are disappointed here by what we may do with Gramm-Rudman-Hollings. Time will tell.

Mr. HICKS. That is right. If we have another sequester in 1987, I will change my tune.

ADP SYSTEMS

Senator ABDNOR. OK. Is computer operation completely up to speed, or does more need to be done?

Mr. HICKS. Both. It is up to speed as of today, and we are providing top quality support to the President, the White House Office staff, and to OMB who are the primary users, and to the other agencies in the Executive Office of the President. But I think with any computer operation, more work always needs to be done. We have experienced an increase in demand, especially in the OMB area, not only with Gramm-Rudman-Hollings, but also in the budget preparation system. This system allows agencies to feed their budget data directly into the OA mainframe that we maintain for OMB. Additional capacity is being added.

Both the White House Office and OMB are reviewing their office automation systems, their local area networking ideas. There are a variety of other initiatives that we could undertake to improve the service so that there is more work to be done, but as of today, we are providing quality ADP support for the Executive Office of the President.

ADDITIONAL COUNCIL OF ECONOMIC ADVISORS POSITIONS

Senator ABDNOR. Very good. Last year we reduced the Council of Economic Advisors in concert with the budget request. Now this year the restoration of these positions is being requested with very little change in the funding request. Why the change of heart in the positions, and will any part of the activity change under this budget request?

Mr. HICKS. The reason for the change is a new chairman. During the first 4 years, Chairman Feldstein staffed the Council under-ceiling for most of his tenure. Last year's request, I think, was a manifestation of his practice. Chairman Sprinkel has determined that in order to provide the level of service to the President that he thinks is necessary, those five positions that were dropped last year need to be restored. That is one full-time permanent position plus four full-time equivalents, so it is not five full-time positions.

Senator ABDNOR. Say that again. One full-time and four equivalent.

Mr. HICKS. One full-time and four equivalents so it will be made up of part-time people, or intermittent employees. I do not believe the activity will change. The reason the funding is not more is that rather than asking for more money, Chairman Sprinkel is asking to reprogram money that funded the Intergovernmental Personnel Act [IPA]. This is a program where CEA can reimburse a university for the salary of an academician for a period of time, generally 1 year. The Chairman wants more continuity on his staff, and would like to have them as permanent employees rather than using the IPA Program.

We are reprogramming the money from that program into the personnel account.

OFFICE OF POLICY DEVELOPMENT FUNDING

Senator ABDNOR. The Office of Policy Development is requesting a reduction from the fiscal year 1986 levels with no change in personnel. How is this being accomplished, and will the positions be regarded left unfilled?

Mr. HICKS. Actually, there is a change in personnel, but not in the personnel ceiling request. The Office of Policy Development was another agency that for the first years of this administration did not staff up to its ceiling. Last year, a major reorganization of the policy development apparatus took place in the White House. Part of OPD's activity goes to support the Cabinet Council operations. These seven Cabinet Councils of the first term were consolidated into two Cabinet Councils, the Economic Policy Council and the Domestic Policy Council.

Based on that organization, it is expected that both the Cabinet Council function and the Policy Development function will eventually be staffed up to its full personnel ceiling. But since they have not been at their ceiling in some years, it will not mean a reduction in personnel.

BLAIR HOUSE

Senator ABDNOR. I do have some other questions. Maybe we will submit them for the record, if we can. I want to ask one that I have been wondering about, and that is a couple of years ago, when we got into this renovation of the Blair House, how are we doing on that thing?

Mr. HICKS. Terry Golden could probably answer that question better than I.

Senator ABDNOR. Oh, is he the guy I should ask?

Mr. HICKS. We have an overlapping relationship. As you know, our buildings are owned and maintained by the General Services Administration. Blair House is part of the GSA White House district.

Part of my responsibility is to oversee the GSA operations in the White House complex. I work with Terry and his staff on the premises to maintain our facilities so that I have a hand in some of the matters that are going on in Blair House. I have the Executive Office of the President facilities manager meet regularly with the contractor and the GSA representatives.

I would be happy to provide a more accurate report for the record on where we are.

Senator ABDNOR. I would like to see it. I think it would be good.

Mr. HICKS. The construction is underway. The demolition started last fall, I think October or November, and they are well on their way. Of course, the State Department is also involved because part of the funding for the construction is private money donated through the State Department curator's operation. The State Department's Protocol Office as well as the Curator's Office will be involved with actually running the place and filling the place with furniture. It is one of those operations where you have everybody involved, the White House, GSA, State Department, and probably more.

Senator ABDNOR. All right. I was concerned about the building when it started.

Mr. HICKS. It is moving along, and I will be happy to supply an update for the record.

Senator ABDNOR. I am going down to look at it when it is finished. I saw it before it started. I had to get used to Washington prices, I guess. The overall figure for what was being done sounded rather large, but they convinced me that it was very necessary.

Mr. HICKS. I think it is. If you saw it before it was redone, or before the construction was started, it was almost an embarrassment that that is where we housed official visitors. It is called the President's guest house, but obviously, it is really the guest house of the people of the United States, and I think the people would agree that foreign visitors deserve better.

Senator ABDNOR. When do you think it will be completed?

Mr. HICKS. I don't know frankly.

Senator ABDNOR. Another year?

Ms. PEARSON. Yes; yesterday the Washington Post had an article on it. They estimated a completion date somewhere around 1990, but GSA is estimating a 1987 completion date.

Mr. HICKS. I think that is right.

Senator ABDNOR. What do you do in the meantime?

Mr. HICKS. It is my understanding that they use hotels. For a time, several hotels were used, but I believe they now have a contract with a particular hotel. The staff who are part of the State Department's Protocol Office and are normally at the Blair House, are still responsible for hosting the foreign visitor at the hotel just as if they were in Blair House.

CLOSING REMARKS

Senator ABDNOR. Thank you, Chris, and Ursula; we wish you well. We hope you decide to reverse your decision and stay. And Ron, thank you for appearing today.

Ms. PEARSON. Thank you very much, Mr. Chairman. I have been a silent witness for the last 7 years, but I do wish to tell you how much I appreciate the help you have given, particularly me, as a financial manager. I would not have been able to handle my job as well if it were not for you and your staff—Chuck Parkinson and Dorothy Pastis, because every time I sign a schedule for payment I represent the taxpayers.

Senator ABDNOR. You bet.

Ms. PEARSON. I take this very seriously, and I think you can see it by the many times our budget has gone down, or we have returned at year end money to the Treasury, that I am very sincere in my job. So when we ask for more money, I hope you really truly believe that we do need it. You have always supported us and I again want to thank you very much.

Senator ABDNOR. That is very kind of you, and we enjoy working with you. I am sure I speak for both my staff people here who I am sure you have to deal with quite often. We do hope you will be back so we can keep working with you.

Ms. PEARSON. Thank you.

Mr. HICKS. I will try to get her to announce her retirement every year so she can come and say nice things like that.

Senator ABDNOR. Good idea.

Mr. HICKS. Thank you, Senator.

PREPARED STATEMENT AND ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Thank you.

We will insert your statement in the record at this point along with the questions which we would like you to respond to.

[The information follows:]

BIOGRAPHICAL SKETCH OF CHRISTOPHER HICKS

Christopher Hicks was appointed as the Deputy Assistant to the President for Administration on February 3, 1985. He also serves as Director of the Office of Administration. Before his appointment, Mr. Hicks served as the Executive Assistant to the Secretary of Treasury and Executive Secretary of the Treasury Department.

From May 1982 to December 1983, Mr. Hicks, 35, was the Associate Director (Economic and Transportation Group) of the Office of Presidential Personnel at the White House. From March 1981 to May 1982, he was Associate Counsel in the Office of the Counsel to the President.

Prior to joining the Reagan Administration, Mr. Hicks was a trial attorney with the firm of Fulbright & Jaworski in Houston, Texas. He also served for a year as a law clerk to the Supreme Court of Texas.

Mr. Hicks received his Bachelor of Arts degree from Colorado College in Colorado Springs, Colorado in 1972 and earned his J.D. from Southern Methodist University in 1977. At SMU, he was an editor of the law review, an officer of the student government and a member of Barristers (an honorary scholastic/service organization).

Mr. Hicks is married to the former Elizabeth Bellamy and they have two sons.

BIOGRAPHICAL SKETCH OF URSULA H. PEARSON

Ursula H. Pearson is the Director for Financial Management for the Executive Office of the President, Office of Administration. She has served in this position since April 1979. She is responsible for Budget, Accounting, Travel, Payroll, and Imprest Fund for twelve appropriations of the Executive Office of the President.

Mrs. Pearson started her government accounting career in January 1968 with the Department of the Interior, National Park Service. In 1971, she transferred to the Office of Naval Research as an operating accountant. In 1975 she was assigned to the Navy Materiel Support Activity as a Systems Accountant in charge of financial systems development for major Navy accounting systems.

Mrs. Pearson was born on August 31, 1924, in Breslau, Germany. She received her degree in Languages in 1947 from the University of Berlin with a major in English. From 1948 to 1951 she owned a translating and interpreting office in Berlin. In 1951 she came to the U.S. where she was the proprietor of a restaurant in Long Island, New York. She served with the Air Force in a civilian capacity in Wiesbaden, Germany from 1960 to 1966. She attended SW State College in Oklahoma and continued her accounting studies at the University of Virginia. She is a member of the Association of Government Accountants. Mrs. Pearson and her husband, John, live in Alexandria, Virginia.

BIOGRAPHICAL SKETCH OF RONNIE R. RASMUSSEN

Ronnie R. Rasmussen is the Budget Officer for the Office of Administration, Executive Office of the President, and has served in this capacity since August 1981.

Prior to his appointment to this position, Mr. Rasmussen was Deputy Chief of the Financial Management Division with the U.S. Secret Service, an organization in which he has served in varying financial related positions since 1973. Mr. Rasmussen specifically assisted in the automation of their financial accounting system, served as the Staff Assistant to the Assistant Director for Administration and in addition, acted as the Administrative Coordinator for the 1980 Presidential Campaign.

Mr. Rasmussen was born January 19, 1946, and raised in Akron, Ohio. While serving in the U.S. Navy, he was assigned to the White House Communications Agency from 1965 to 1969. He then worked for the National Security Council while attending the American University, where he obtained his Bachelor of Science degree in Accounting in 1973.

Mr. Rasmussen has been a member of the Association of Government Accountants since 1973, and is a recipient of the Presidential Service Badge and Certificate.

STATEMENT OF CHRISTOPHER HICKS

Compensation of the President

The Fiscal Year 1987 budget request for Compensation of the President is $250,000. This includes the $200,000 for the direct salary of the President as authorized by 3 U.S.C. 102. This amount has remained constant since 1969. In addition, there is a $50,000 expense account for official use by the President; any unused portions revert to the Treasury. This expense account is not considered as taxable to the President.

The White House Office

The mission of the White House Office is to ensure that the best possible support is provided to the President of the United States.

Before you is the Fiscal Year 1987 budget request which totals $25,179,000. This is less than was appropriated for FY 1985 and is a one percent increase of $273,000 over the FY 1986 enacted amount. The requested increases are due primarily to partial restoration of funding for the five percent pay reduction which was planned for FY 1986 but not enacted, and to increased costs for telephone service and other leased equipment.

These funds will provide for 322 full time permanent positions. This staffing level has remained unchanged since FY 1982.

We have tried to keep this budget request to a minimum, including in it only those costs which are absolutely essential for the continuation of the White House Office's important functions.

In closing, let me say that I am grateful to the Committee for your past understanding and look forward to continuing support for our future operation.

Office of Administration

The appropriation request of the Office of Administration (OA) will enable the agency to provide common administrative support and services to all agencies of the Executive Office of the President (EOP) including the White House Office.

The proposed FY 1987 appropriation request for OA is $16,238,000 which represents an increase of $641,000 or 4.1 percent over the FY 1986 appropriation of $15,597,000 and a $2,000 reduction from the FY 1985 appropriation of $16,240,000.

Included in this request is partial restoration (65.8 percent or $173,000) of the proposed FY 1986 five percent pay reduction. The majority of the increase comes from uncontrollable cost increases charged primarily from other government agencies. These include (1) rising printing costs, (2) rising utility costs comprised largely of telephone and after-hour utilities charges, (3) an increase in the EOP's share of payroll processing charges to the Department of Treasury, and finally, (4) the need to cover the increased workload and costs associated with the operation of the Executive Office of the President Computer Center (EOPCC). Aside from the annual cost increases for the facility contract, additional resources are required to support the administrative systems recently transferred from the WHCA computer facility to OA. Staffing levels remain unchanged.

Beyond these appropriated funds, OA is anticipating $3,004,000 in reimbursements for ADP systems development. This represents a $262,000 or 9.56 percent increase over estimated FY 1986 reimbursements.

In closing, I would like to express my gratitude to you and the Committee for your continued support. Without it, OA would not be able to continue to give the White House and the EOP the support which it requires and deserves.

Special Assistance to the President

The appropriation request for Special Assistance to the President asks for funds to enable the Vice President to provide assistance to the Chief Executive which includes directed and special Presidentially-assigned functions. Additionally, the Vice President through Cabinet membership and White House contact is informed on a continual basis regarding Presidential responsibilities and in the President's absence serves as Chairman of the Cabinet.

In addition to his current Presidential assignments, the Vice President also serves as an advisor to the President on matters of national importance, and assists in ceremonial functions and in the conduct of international affairs.

For FY 1987, an appropriation of $1,849,000 is being requested for the Special Assistance to the President account. This request is $55,000 greater than the FY 1986 appropriation of $1,794,000. Reflected in this request is $10,000 for a partial restoration of the annualized cost of the proposed FY 1986 five percent pay reduction, $20,000 is needed to offset the rising cost of after hour utilities and telephone services and the remaining $25,000 will ensure the continuation of our office automation efforts.

These funds will also provide for 24 full-time permanent employees. No additional positions are being requested.

In closing, I would like to express my gratitude to you and this committee for your continual support of the Vice President during the past year, which included a significant transition in staffing.

Council of Economic Advisers

The Council of Economic Adviser's Fiscal Year 1987 appropriation request will provide the resources needed to comply with the Employment Act of 1946 which mandates the Council's activities. The most important include compiling and analyzing current and future economic developments and reporting these findings to the President. In addition, the Council assists and advises the Chief Executive in preparing the annual Economic Report.

For Fiscal Year 1987, the Council of Economic Advisers request an appropriation of $2,346,000. This request is an increase of $45,000 over our current Fiscal Year 1986 funding level of $2,301,000 and a decrease of $214,000 from our Fiscal Year 1985 authority of $2,560,000. These funds will provide for 34 full time permanent positions and 4 others. This represents a restoration of the 5 positions the Council was cut in 1986. Based on a review of the Council's staffing resource, I feel it is necessary to have these positions restored. By reprogramming, we are able to add these positions without full funding.

The appropriation we have requested for Fiscal Year 1987 provides what we feel is a realistic level of support for the Council; it reflects also our commitment to producing the best possible work in the most effective manner.

Office of Policy Development

The Office of Policy Development is responsible for advising and assisting the President in a wide range of issues and for supporting the cabinet-level bodies designated as the primary channels for advising the President on policy matters.

During the past year, we have made some changes in the White House policy development process. In April of 1985, the previous seven Cabinet Councils were replaced by two new cabinet-level bodies -- the Economic Policy Council and the Domestic Policy Council. The President chairs both Councils. The Economic Policy Council provides advice on all aspects of national and international economic policy. The Domestic Policy Council provides advice on domestic and social policy. The Office of Policy Development makes input to and provides administrative support for both Councils.

The 42 staff positions of the Office of Policy Development provided by this request will support the two cabinet councils and perform the formulation, evaluation, and coordination functions necessary to guide long range economic and domestic policy. We continue to work closely with the National Security Council in areas where domestic policy includes international considerations.

The Office of Policy Development also supports several other functions within the Executive Office of the President, including the offices of Cabinet Affairs, Drug Abuse Policy and the President's Economic Policy Advisory Board.

Our FY 1987 budget request is $2,665,000. This is a reduction of $61,000 from our FY 1986 funding level of $2,726,000 and a decrease of $355,000 from our FY 1985 authority. This proposed request will provide for a staff of 42 full-time permanent employees, the same as currently authorized, while ensuring the continuation of our support and operations during FY 1987.

Again, I welcome the opportunity to explain the budget request and would like to thank the Chairman and the members for their support. I recognize that the excellent data processing capability of the Office of Policy Development is a direct result of the interest and support of this Committee.

National Security Council

The National Security Council (NSC) was established by statute after World War II to provide a mechanism for review and decision by the President of policies relating to the national security. The flexible structure of the NSC system allows for coordinated development, presentation, and implementation of policy decision. Faced with the realities of an increasingly complex and ever-changing world situation, this system has proved to be a durable institution.

Before you today is our FY 1987 request of $4,627,000 which is the same as our current FY 1986 authority. This appropriation will provide for (1) the permanent professional staff of 61 which supports the National Security Council, (2) their operating costs, and (3) funding for the operation of the President's Intelligence Oversight Board and the President's Foreign Intelligence Advisory Board.

This request will ensure the continued support and operations of the National Security Council staff and their vital role during FY 1987 while demonstrating fiscal restraint.

National Critical Materials Council

The mission of the National Critical Materials Council, which was created by the National Critical Materials Act of 1984, is very broad. The Council is currently developing an agenda to meet the requirements set out by the Act. A partial listing of these requirements includes establishing a national federal program plan for advanced materials research and development, preparing a domestic inventory of critical materials, making projections for future materials needs, and providing any reports to the President, Congress, as may be needed.

In developing this agenda, the Council is relying on the knowledge and experience of public and private experts in critical materials. In January 1986, the Council held its first meeting attended by numerous representatives of the mining and minerals processing community, groups concerned with national security and minerals availability issues, and groups concerned with advanced materials research and development.

Concurrent with the development of its agenda, the Council will also be the establishing its operational framework. Since the Council is still in the formulative stage, we are unable to identify firm start-up costs. However, we anticipate that our FY 1986 funding level will be more than adequate in meeting our needs. Once established, the proposed FY 1987 budget request of $250,000 will provide for the Council's operations and ensure that its Congressionally-mandated responsibilities are fulfilled.

Funds Appropriated to the President
Unanticipated Needs

In 1940, Congress recognized the need to provide the President with funds to meet unbudgeted contingencies. The sum of $1,000,000 has been provided to meet the President's unanticipated needs since 1962. Once again we are requesting the same amount.

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Extreme prudence is always used when making an allocation from this fund. Each request is reviewed by the Office of Management and Budget (OMB) to ensure that the purpose is consistent with the Administration's policies. Each request is also verified for the accuracy of the estimated need as well as to confirm that no alternative resources exist.

All requests are then sent to the President with OMB's recommendation. The President makes the final determination as to whether the allocation should be made. This process ensures that allocations are made for only the most important purposes.

In FY 1985 and to date in FY 1986, allocations have been made to the Vice President's Office for the creation and operation of the Vice President's Task Force on Combatting Terrorism.

ADDITIONAL COMMITTEE QUESTIONS

QUESTION: Would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

ANSWER: To do so would require the Executive Office of the President (EOP) to reduce the level of services currently provided to the President, and therefore, should not be considered a viable option. It is important to remember that the enacted FY 1986 base for the EOP was already below the FY 1985 enacted level. With the exception of one agency, the FY 1986 EOP base contained the proposed five percent pay reduction which was not restored by Congress, and the administrative reductions of which the Office of Administration absorbed $559,000.

Within this already reduced base for FY 1986, additional workload was realized primarily in the area of ADP support. Included in this workload are the operational costs of the transferred administrative system, during the later part of FY 1985, from the White House Communications Agency to the EOP Computer Center, and the operational support of data processing and reporting in support of GRH, which will occur again in August and September.

Each of these accounts are operating with the GRH FY 1986 reductions; however, the reductions are being accomplished through one-time and temporary measures. None of these accounts are trying to recoup its GRH FY 1986 reductions in their FY 1987 budget request. The additional monies will cover only bona fide inflationary cost increases which the EOP has little flexibility due to the nature of its labor intensive operations. Our FY 1987 budget represents the absolute minimum funding requirements needed to continue their respective roles and responsibilities and, although a slight increase over FY 1986 enacted, is still below FY 1985 funding.

Whether the GRH FY 1986 funding level was used as a base, or if a similar reduction was made of our FY 1987 request, it would represent an additional four percent accross-the-board reduction. Should this materialize, we would be forced to reevaluate our programs and priorities resulting in a more permanent action to achieve lower personnel costs, reduced services, and the cessation of all new ADP initiatives.

QUESTION: How well has the Executive Office done in reaching the 135 square foot limit?

ANSWER: We are not as far along on this project as we would like to be, but we continue to work toward reaching this goal. For the most part, the agencies of the Executive Office of the

President (EOP) are housed in the East and West Wings of the White House, the White House itself, the Old Executive Office Building (OEOB), and the Winder Building. Due to the historical nature of these buildings, and their architectural significance, little flexibility exists in changing structural configurations. Security considerations also are a factor.

Only the New Executive Office Building (NEOB) offers significant flexibility and every effort has been made to maximize the utilization of space and comply with the President's directive.

QUESTION: Funding is requested for the Critical Materials Council, yet no full time positions are being requested. How will the positions be handled?

ANSWER: The Council will be staffed by personnel on detail from other agencies and will rely on extensive input from government entities involved in critical materials management. All government agencies will be fully reimbursed for personnel as well as any other support costs.

QUESTION: The funding request for the National Security Council is equal to last year. Am I to assume that this can be done because all of the positions were not filled last year?

ANSWER: You are correct in stating that NSC's funding level remains unchanged from FY 1986 and that a number of vacancies contributed to a relatively large lapse at year-end 1985. More recently, NSC has gone through a transition and is in the process of reaching full staffing levels. The Committee may remember, however, that NSC was the only EOP agency that did not take the five percent pay reduction in FY 1986. Consequently, NSC's FY 1986 budget was proportionately higher than other agencies within the EOP.

DEPARTMENT OF THE INTERIOR

National Park Service

Executive Residence at the White House

STATEMENT OF MANUS J. FISH, REGIONAL DIRECTOR OF THE NATIONAL PARK SERVICE, NATIONAL CAPITAL REGION

ACCOMPANIED BY:

JIM MCDANIEL, ASSOCIATE REGIONAL DIRECTOR
ALLYSON ROWELL, BUDGET ANALYST, NATIONAL PARK SERVICE

PREPARED STATEMENT

Senator Abdnor. Welcome back to the committee, Mr. Fish. You are our final witness today, as you can look around the room and tell. [Laughter.]

Senator Abdnor. We are happy to have you with us. Mr. Fish is the Regional Director of the National Park Service of the National Capital Region. We are anxious to hear from you. We will put your entire statement in the record. You can proceed any way you want to.

[The statement follows:]

Statement of Manus J. Fish, Jr.

Mr. Chairman, and members of the committee, I appreciate the opportunity to appear before you to present, for your consideration, the fund requirements for the maintenance and operation of the Executive Residence at the White House for fiscal 1987.

The appropriation for this account for fiscal 1986 is $4,577,000. The fiscal 1987 appropriation request is $4,942,000. Nonrecurring funds are being sought to renew deteriorating floors in the Red, Green, and Blue Rooms ($125,000). The Green Room, the Blue Room, and the Red Room will be refitted with new hardwood flooring. The wooden floors in the Executive Residence first floor State Rooms were installed during the 1948–52 renovation.

Since 1952, the floors have been walked on by an estimated 35 million visitors, tourists, and guests. Repairs to the floors have been made by sanding the surface and then refinishing them; this process has been performed three times on the Red and Green Room floors and four times on the Blue Room floor. The surface of the floors has been worn to the point that the nails and the tongue-and-groove joints which hold the floor together are exposed and only emergency patches can be made to the floor. The repairs are easily noticed and detract from the appearance of these historic rooms. The East Room flooring, also installed during the 1948–52 renovation, was replaced in 1977 for the same reasons.

Also requested are personnel costs including the restoration of the 5-percent salary reduction absorbed in this budget in fiscal year 1986 and not subsequently restored ($180,000).

In addition to providing for the increased cost of supplies, materials, and other services, an amount is also requested to perform equipment, utilities and facilities maintenance that was deferred in fiscal year 1986 and to restock filters, steam valves, and other supplies used, but not replaced in fiscal year 1986 ($60,000). No changes in FTE's are proposed in this request.

This concludes our budget request Mr. Chairman, but at this time I would like to bring to your attention the fact that Mr. Rex Scouten, chief usher for the White House for the last 16 years, retired this last January. From the very beginnings of his Federal service career, Rex Scouten's paramount concern has always been the comfort and safety of the Nation's Chief Executive and his family. President Ronald Reagan cited his accomplishments by presenting him with the President's award for Distinguished Federal Civilian Service in an Oval Office ceremony on February 7, 1986. We in the Federal service join the President in commending Rex Scouten's life of public service and salute him as a wise guardian and steward of one of this Nation's foremost historic treasures. I would appreciate the opportunity to submit a full statement of Mr. Scouten's accomplishments for the record. Mr. Gary Walters, who served as assistant chief usher, has been appointed by the President to succeed Mr. Scouten.

Mr. Chairman, I shall be pleased to answer any questions you and other members of the committee may have about the operation of the Executive Residence and the budget request before you.

INTRODUCTION OF ASSOCIATES

Mr. FISH. Thank you, Mr. Chairman. I would like to introduce Mr. Jim McDaniel, the Associate Regional Director, and Mrs. Allyson Rowell, a budget analyst in the National Park Service, her first time before this committee, Mr. Chairman.

Mr. Chairman, I appreciate the opportunity to appear before you to present for your consideration the fund requirements for the maintenance and operation of the Executive Residence at the White House for fiscal 1987.

NEW FLOORING IN THE WHITE HOUSE

The appropriation for this account for fiscal 1986 is $4,577,000. The fiscal 1987 appropriation request is $4,942,000. Nonrecurring funds are being sought to renew deteriorating floors in the Red, Green, and Blue rooms, $125,000. The Green Room, the Blue Room, and the Red Room will be refitted with new hardwood flooring. The wooden floors in the Executive Residence first floor staterooms were installed during the 1948–52 renovation.

Since 1952, the floors have been walked on by an estimated 35 million visitors, tourists, and guests. Repairs to the floors have been made by sanding the surface and then refinishing them. This process has been performed three times on the Red and Green Room floors, and four times on the Blue Room floor.

The surface of the floors has been worn to the point that the nails and the tongue-and-groove joints which hold the floor together are exposed, and only emergency patches can be made to the floor. The repairs are easily noticed and detract from the appearance of these historic rooms.

The East Room flooring, also installed during the 1948–52 renovation was replaced in 1977 for the same reasons. Also requested are personnel costs including the restoration of 5 percent salary reductions absorbed in this budget in fiscal 1986, and not subsequently restored.

In addition to providing for the increased cost of supplies, materials and other services, an amount is also requested to perform equipment, utilities, and facilities maintenance that was deferred in 1986, and to restock filters, steam valves and other supplies used but not replaced in 1986. No changes in FTE's are proposed in this request.

REX SCOUTEN'S RETIREMENT

This concludes our budget request, Mr. Chairman, but at this time, I would like to bring to your attention the fact that Mr. Rex Scouten, chief usher for the White House for the last 16 years, retired this last January. From the very beginnings of his Federal service career, Rex Scouten's paramount concern has always been the comfort and safety of the Nation's Chief Executive and his family.

President Ronald Reagan cited his accomplishments by presenting him with the President's Award for Distinguished Federal Civilian Service in an Oval Office ceremony on February 7.

We in the Federal service join the President in commending Rex Scouten's life of public service and salute him as a wise guardian and steward of one of this Nation's foremost historic treasures. I would appreciate it, Mr. Chairman, if I might have the opportunity to submit a full statement of Mr. Scouten's accomplishments for the record.

Senator ABDNOR. We would be very, very happy to have it.

Mr. FISH. Thank you, Mr. Chairman. I know he would appreciate that.

Senator ABDNOR. It is our pleasure to have a man like Mr. Scouten in the record here.

[The information follows:]

REX W. SCOUTEN

After more than 37 years of distinguished Federal service—the last 16 as chief usher of the White House—Rex Scouten retired on January 3, 1986.

President Ronald Reagan cited Rex Scouten's superior accomplishments by presenting him the President's award for Distinguished Federal Civilian Service in an Oval Office ceremony on February 7, 1986. In commending Rex Scouten, the President stated that he "has consistently demonstrated resourcefulness, good taste, sound judgment, and tireless devotion to duty." The President also said "Rex Scouten has been a model civil servant, a living paradigm of the high ideals and devotion to duty of all unsung heroes who dedicate their lives to serve their country with unfailing zeal, honor, and fidelity."

From the very beginnings of his Federal service career, Rex Scouten's paramount concern has always been the comfort and safety of the Nation's Chief Executive and his family. As a special agent with the U.S. Secret Service from 1949 to 1957, Rex Scouten exercised vigilance and self-sacrifice in protecting the First Family.

After 8 years with the U.S. Secret Service, Rex Scouten became assistant usher at the White House, where he continued his pursuit of safety, privacy, and comfort for the First Families he would serve.

From 1966 to 1969, Rex Scouten worked with the National Park Service as assistant regional director for White House liaison. In this position he made significant contributions to Lady Bird Johnson's beautification campaign and strengthened the National Park Service's role in historic preservation and interpretation of the White House.

Rex Scouten returned to the White House in 1969 as chief usher, serving as "Major-Domo" until his retirement in 1986. An enumeration of Rex Scouten's accomplishments in service to the Chief Executive and his family would be nearly ceaseless. He has traveled in 35 countries to coordinate preparations for Presidential travel; he has planned and supervised major ceremonies of state, in happy times and in sad; he has carefully watched over the development of the formal gardens and grounds of the White House in strict adherence to the historic landscape design; and he has tirelessly provided for the enjoyment of the White House residence by the many First Families he has served.

We in the Federal service join the President in commending Rex Scouten's life of public service and salute him as a wise guardian and steward of one of this Nation's foremost historic treasures.

GRAMM-RUDMAN-HOLLINGS REDUCTIONS

Mr. FISH. Mr. Gary Walters who served as Assistant Chief Usher, Mr. Chairman, has been appointed by the President to succeed Mr. Scouten.

Mr. Chairman, I would be pleased to try to answer any questions you might have.

Senator ABDNOR. Thank you. Mr. Fish, we really do not have that many questions for you because you always do a fine job. I might ask you, though, if you have any troubles with the Gramm-Rudman-Hollings, or are you able to move around that?

Mr. FISH. Mr. Chairman, we did have to reduce. We had to cut back on certain programs. We had to reduce on supplies and materials, painters' and carpenters' supplies, electrical supplies, plumbing supplies, the replacement of linens for the White House, replacement of glassware. We also had to cut down, or reduce, acquisition of furnishings. There are some times when a piece of furniture or art becomes available, so last year or this year, 1986, we were not in the position to make that sort of opportunity purchase.

Senator ABDNOR. Are you going to be able to make up the difference in 1987 with what we have here?

Mr. FISH. Yes, sir. With this budget, we feel that we would.

Senator ABDNOR. All right. You have not had to lay off much manpower then?

Mr. FISH. No, sir. What we did do, though, we tried to schedule events at the White House, official ceremonies and functions, on regular working hours which we have found is not too easy. But we tried to do that so that we could cut back on the premium pay that we would have to give to the employees.

WHITE HOUSE FLOORING

Senator ABDNOR. Obviously, your major project over there this year is the flooring in some of those rooms. That is for now, but how does the future look? Have you a lot of this each year to catch up, or are you keeping up pretty well?

Mr. FISH. Yes, sir. As I mentioned, the East Room floor was done in 1977, and I have an example, Mr. Chairman, of the flooring. Maybe Mr. McDaniel might show you the pictures also, the patches, the nails that come through. It has worn down so thin. The top portion should be the same thickness as the bottom portion.

Senator ABDNOR. What room is this in? This is the East Room?

Mr. FISH. This is an example of the Red and Blue and Green Rooms, Mr. Chairman, and those photographs are examples of what I mentioned before about the patches, the unsightly patches, and the nails showing through.

Senator ABDNOR. Oh, the top has been sanded.

Mr. FISH. That is right. The top has been sanded, and it originally was the thickness of the bottom piece.

Senator ABDNOR. Oh, really. Good thing it is solid all the way through; isn't it?

Mr. FISH. But to answer your question——

Senator ABDNOR. Is that type of flooring still available?

Mr. FISH. Yes, sir. I think probably it would be a good oak flooring.

Senator ABDNOR. I mean cut that way?

Mr. FISH. Oh, yes, sir.

Senator ABDNOR. OK. I am not much of a carpenter.

Mr. FISH. Nor am I, Mr. Chairman. My wife can attest to it. [Laughter.]

But to answer your question, we would see that perhaps in a few years the State Dining Room, which is on the west side, would be in need of this same type of replacement flooring because that is the way the visitation goes through. Visitors come up the steps from the ground floor, then into the East Room, which we now have replaced, and then through the Green, Blue and Red Rooms, and then on into the dining room, and then on out the front door.

Senator ABDNOR. You replaced the whole floor in 1977 in the East Room; right?

Mr. FISH. Yes, sir.

Senator ABDNOR. How long can you expect a floor like that to hold up?

Mr. FISH. As I say, the House was completely gutted, you might say, in 1948 and restored in that period of 1948–52, during the Truman administration, if you recall.

Senator ABDNOR. That is what we are talking about today.

Mr. FISH. Then the President moved over to—you were discussing Blair House—moved over to Blair House. So all these floors date back to that 1950, you might say, vintage.

Senator ABDNOR. There are no fewer people walking through there today than 1948, I can assure you of that. As a matter of fact, I would hate to think how many more. You do not have anything to do with the Blair House, do you?

Mr. FISH. No, sir, we do not.

Senator ABDNOR. Can you give us for the record a brief overview of your recent improvements in the building?

Mr. FISH. Yes, sir. We would be glad to do that.

[The information follows:]

OVERVIEW OF RECENT IMPROVEMENTS IN THE EXECUTIVE RESIDENCE

Exterior restoration of the White House (painting).—The second phase of the exterior restoration, the North Portico, was completed in spring 1985. Restoration began in 1980 after a 2-year study which provided recommendations which would improve the appearance of the White House exterior and lower the cost of maintenance.

Truman balcony.—Work accomplished in 1983 included the replacement of the badly deteriorated steel fascia/gutter with nonrusting fiberglass, deck surface, and waterproofing replacement, and the replacement of the wrought iron railing.

West Garden Room redesigned.

Damaged South Portico stone steps replaced.

Visitor restrooms under the South Portico renovated and made accessible to the handicapped.

Walkways adjacent to the North Portico were repointed and caulked.

Flagstone walkways under the Jackson magnolias and the President's walkway removed, leveled, and reset.

State Dining Room received a specialty glazed paint treatment.

Deteriorated kitchen cabinets replaced in the first floor pantry.

Musuem quality storage facility constructed in the basement. This facility stores the permanent art collection not currently on display.

Replacement of the deterioriated stone and stone carvings on the North Portico.

WHITE HOUSE HISTORICAL ASSOCIATION PRINTS AND BOOKS

Senator ABDNOR. Very good. I really do not have any further questions. You are doing fine work, and we are happy to have you here. We look forward to seeing you folks again.

Mr. FISH. Thank you, Mr. Chairman. If I may highlight the work that the calligraphers on this staff do, we would just like to present you with some samples of their work for the dinner last night for the Canadian Prime Minister.

Senator ABDNOR. Thank you.

Mr. FISH. We also have copies of the prints, Mr. Chairman, that are sold by the White House Historical Association. The revenues, the profits from the White House Historical Association, and this is typical for just about every national park in the country, are used for publications which provide a better understanding, a better interpretation of the particular national park area. In this case it is the White House.

So the White House Historical Association, headed by Dr. Melvin Payne, wanted you to have those, Mr. Chairman. Those are copies of all the prints that are sold, along with——

Senator ABDNOR. This is like Christmas.

Mr. FISH. We would like to give you the books that are sold by the White House Historical Association. Again, I think it is very important because you certainly get a good understanding going through the House, walking through the House, but then these are reference materials.

Senator ABDNOR. Next time I am going through, I will call you personally to give me a tour.

Mr. FISH. I would be delighted, Mr. Chairman.

Senator ABDNOR. And the Blair House, too. [Laughter.]

These are lovely. They will be nice on any wall. Thank you. And you tell the other folks thank you for this.

Mr. FISH. We will, Mr. Chairman. Thank you. We have a set of the books for everyone, if that is OK?

Senator ABDNOR. Fine. Thank you. Those are nice books. Some day I might even get time to spend some time reading about some of these things that I should know more about.

NAVY DEPARTMENT STATEMENT ON VICE PRESIDENT'S RESIDENCE

I have a statement here for the justification prepared by the Department of the Navy for the Residence of the Vice President. I ask unanimous consent that this package be made a part of the record at this point.

[The statement follows:]

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICIAL RESIDENCE OF THE VICE PRESIDENT

For the care, maintenance, repair, and alteration, furnishing, improvements, heating and lighting, including electric power and fixtures, of the official residence of the Vice President, and not to exceed $60,000 for official entertainment expenses of the Vice President, to be accounted for solely on his certificate; $211,000: Provided, That advances or repayments or transfers from this appropriation may be made to any department or agency for expenses of carrying out such activities.

Note.—A regular 1986 appropriation for this account had not been enacted at the time this budget was prepared. A continuing resolution (Public Law 99-190) provides funds to the extent and in the manner provided for in the conference version of H.R. 3036, Treasury, Postal Service and General Government Appropriations Act, 1986, as amended by Public Law 99-190.

DEPARTMENT OF THE NAVY

OFFICIAL RESIDENCE OF THE VICE PRESIDENT

PROGRAM AND FINANCING

		Fiscal year—		
	Identification code 11-0211-0-1-802	1985 actual	1986 estimate	1987 estimate
	PROGRAM BY ACTIVITIES			
	Direct program:			
10.	Support of the official residence of the Vice President	$219,000	$204,000	$211,000
40.	Budget authority (Appropriation)	219,000	204,000	211,000
	Relation of obligations to outlays:			
71.	Obligations incurred, net	219,000	204,000	211,000
72.	Obligated balance, start of year	95,000	269,000	88,000
74.	Obligated balance, end of year	-269,000	-88,000	-72,000
90.	Outlays	46,000	385,000	227,000

OBJECT CLASSIFICATION

Identification code 11-0211-0-1-802	Fiscal year— 1985 actual	 1986 estimate	 1987 estimate
Direct obligations:			
10. Other services	$46,000	$385,000	$227,000

SUMMARY OF BUDGET AUTHORITY AND OUTLAYS

Identification code 11-0211-0-1-802	Fiscal year— 1985 actual	 1986 estimate	 1987 estimate
Enacted/requested:			
Budget authority	$219,000	$204,000	$211,000
Outlays	46,000	385,000	227,000
Reduction pursuant to Public Law 99-177:			
Budget authority		-9,000	
Outlays		-5,000	-4,000
Total:			
Budget authority	219,000	195,000	211,000
Outlays	46,000	380,000	223,000

DEPARTMENT OF THE NAVY

OPERATING EXPENSES, OFFICIAL RESIDENCE OF THE VICE PRESIDENT

Fiscal year:	
1987 estimate	$211,000
1986 estimate	204,000
1985 actual	219,000

PURPOSE AND SCOPE OF WORK

These funds provide for purchase, lease, and operation of appropriate equipment, furnishings, improvements, alterations, maintenance, repairs, services, and other provisions as may be required under the supervision of the Vice President to enable him to perform and discharge appropriately the duties, functions, and obligations associated with his office. These estimates also include official entertainment expenses of the Vice President.

JUSTIFICATION OF FUNDS

The fiscal year 1987 request of $211,000 will provide for the continuous day-to-day habitability, upkeep, and operational services of the Vice Presidential residence. The incremental change of resources required between fiscal year 1987 and fiscal year 1986 is composed of: an increase of $5,000 for price growth in utilities and other services and an increase of $2,000 for continuing efforts to repair and replaster interior walls and upgrade associated electrical wiring.

The following table reflects the amounts being requested by function:

	Fiscal year—		
	1985 actual	1986 estimate	1987 estimate
Utilities	$30,400	$31,700	$33,000
Other services:			
Maintenance of residence	29,600	30,800	32,200
Rehabilitation and alterations	11,500	12,000	12,600
Supplies	6,900	7,200	7,600
Furnishings	6,800	7,100	7,500
Vehicle lease	2,500	2,600	2,800
General administration	6,300	6,600	6,900
Services	4,900	5,100	5,400
Equipment maintenance	2,800	2,900	3,000
Official entertainment	60,000	60,000	60,000
Replaster/repair interior walls upgrade associated wiring		38,000	40,000
Repair/replace boiler and steam system	12,000		
Replace metal garage roof	12,000		
Replace basement floor tile	9,300		
Install sewer manhole	4,000		
Conduct comprehensive engineering study	20,000		
Total	219,000	204,000	211,000

SUBCOMMITTEE RECESS

Senator ABDNOR. If there is no further business to come before the subcommittee today, we will stand in recess until 10 a.m., tomorrow morning when we will hear testimony from the Secret Service; the Bureau of Alcohol, Tobacco and Firearms; and the Federal Law Enforcement Training Center. We stand in recess.

[Whereupon, at 3:40 p.m., Wednesday, March 19, the subcommittee was recessed, to reconvene at 10 a.m., Thursday, March 20.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

THURSDAY, MARCH 20, 1986

U.S. Senate,
Subcommittee of the Committee on Appropriations,
Washington, DC.

The subcommittee met at 10:20 a.m., in room SD–124, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senator Abdnor.

DEPARTMENT OF THE TREASURY

U.S. Secret Service

STATEMENT OF JOHN R. SIMPSON, DIRECTOR

ACCOMPANIED BY:

- **JILL E. KENT, DEPUTY ASSISTANT SECRETARY, DEPARTMENTAL FINANCE AND PLANNING, DEPARTMENT OF THE TREASURY**
- **DAVID D. QUEEN, DEPUTY ASSISTANT SECRETARY, ENFORCEMENT AND OPERATIONS, DEPARTMENT OF THE TREASURY**
- **LARRY B. SHEAFE, DEPUTY DIRECTOR**
- **DAVID C. LEE, ASSISTANT DIRECTOR, ADMINISTRATION**
- **STEPHEN E. GARMON, ASSISTANT DIRECTOR, PROTECTIVE OPERATIONS**
- **JOSEPH R. CARLON, ASSISTANT DIRECTOR, PROTECTIVE RESEARCH**
- **KEVIN R. HOULIHAN, ASSISTANT DIRECTOR, INVESTIGATIONS**
- **FRANK PALMER, CHIEF, FINANCIAL MANAGEMENT DIVISION**

PREPARED STATEMENT

Senator Abdnor. The subcommittee will come to order.

I apologize for the lateness but I did have a little problem getting here in taking care of some other business.

We will continue our 1987 budget hearing today with testimony from Mr. David Queen, Deputy Assistant Secretary for the Treasury for Enforcement; John Simpson, Director of the U.S. Secret Service; Stephen E. Higgins, Director of the Bureau of Alcohol, Tobacco and Firearms; and Mr. Charles F. Rinkevich, Director, Federal Law Enforcement Training Center.

As I understand it, Mr. Queen will give a brief statement for each agency and will be followed by the Director of each agency who will give a more detailed account of their budget request.

I will not have any opening statement and, for the moment, I do not guess we have anyone else here. We will begin with the Secret Service.

Does Mr. Queen want to go first?

Mr. QUEEN. Mr. Chairman, if there is no objection, I will just simply submit prepared remarks, copies of which were previously sent to the committee, and carry on with the pleasant task of introducing a gentleman you already know anyway, the Director of the Secret Service, Mr. Simpson.

Senator ABDNOR. Very, very good. Your entire statement, Mr. Queen, will be made a part of the record. And the same is true with you, Mr. Simpson. You may proceed in any way you want.

[The statement follows:]

STATEMENT OF DAVID D. QUEEN

It is a pleasure for me to appear before you in support of the annual appropriation request for the U.S. Secret Service. I am testifying because Assistant Secretary Keating is unable to be here today. He is traveling with the Attorney General on a factfinding mission to Thailand, Burma, India, and Pakistan, to investigate the problem of drug trafficking in and through that region.

Appearing with me today are the Director of the Secret Service, John R. Simpson, key Secret Service staff members, and Jill E. Kent, Deputy Assistant Secretary for Departmental Finance and Planning.

The budget request for fiscal year 1987 is $307,140,000. These funds are needed to carry out the vital missions of the U.S. Secret Service, which include protection of the President, Vice President, and foreign heads of state. As you know, Mr. Chairman, the U.S. Secret Service also has a critical investigative mission in protecting the currency against counterfeiting and in investigating credit card fraud, computer fraud, and the theft and forgery of Government obligations. The Secret Service has carried out these missions with determination and enthusiasm.

Protection continues to be the Secret Service's highest priority. During fiscal year 1985, the Secret Service expended more man-hours in protection than in any past non-campaign year. The man-hours devoted to the protective mission represented 58 percent of the total for fiscal year 1985. Just as fiscal year 1985 included the close of the Presidential campaign and the Presidential inauguration, fiscal year 1986 started off with a major special event, the United Nation's 40th General Assembly, for which the Secret Service planned and carried out a challenging protective function. During the period of late September 1985 to October 30, 1985, over 100 heads of state visited New York City for this event. From all reports, the Secret Service did an outstanding job and are to be commended for this fine effort.

As we look to the future, we see that these special events are becoming more numerous. In July of fiscal year 1986, the Statue of Liberty celebration will take place, no doubt attended by many foreign VIP's. During fiscal year 1987, the Pan American Games will be held in Indianapolis. In the spring of fiscal year 1987, Pope John Paul II is scheduled to visit our country. Events such as these pose enormous challenges for the Secret Service, especially in view of the threat of terrorism. Careful and detailed planning, meticulous training and preparation, and continued support and cooperation from local, State, and other Federal law enforcement agencies are essential in meeting these protective challenges.

Even though field agents were devoting much of their time to protection activities, they were still able to perform their criminal enforcement missions effectively. In fiscal year 1985, both arrests (1,378) and convictions (1,591) for counterfeiting exceeded the levels of fiscal year 1984. The Secret Service seized, and kept from being passed to the public, $61.7 million of counterfeit notes. Efforts to suppress counterfeiting overseas have been expanded with the establishment of the Milan, Italy field office. The Secret Service is exploring the possibility of establishing additional foreign field offices.

As our society moves from financial transactions conducted primarily with paper checks and currency, to electronic, computer-based systems, the Secret Service's workload in combating fraud involving computers, credit cards, and electronic funds transfer will continue to grow. The Secret Service is adapting its programs to meet these challenges as our financial system continues to evolve. As an example of this progress, the Secret Service has made an excellent start against the serious problem of credit card crime, with 884 arrests in fiscal year 1985. So far this fiscal year, the Service has made another 559 arrests in credit card cases.

Mr. Chairman, this concludes my opening statement. I will now ask Mr. John Simpson, the Director of the U.S. Secret Service, to provide you with his prepared statement, and we will then be pleased to respond to questions you or other members of the committee may have.

INTRODUCTORY STATEMENT OF JOHN R. SIMPSON

Mr. SIMPSON. Mr. Chairman, if I may read a short introductory statement, the longer statement will be provided for the record, with your permission.

Senator ABDNOR. Please.

Mr. SIMPSON. Mr. Chairman, I am pleased to appear before you and the other members of this committee to present the annual appropriation request of the U.S. Secret Service and to report on our activities during the current and past fiscal years.

With me this morning, Mr Chairman, is Mr. Larry B. Sheafe, Deputy Director; David C. Lee, Assistant Director for Administration; Mr. Stephen E. Garmon, Assistant Director for Protective Operations; Mr. Joseph R. Carlon, Assistant Director for Protective Research; Mr. Kevin R. Houlihan, Assistant Director for Investigations, and also Frank Palmer, Chief of our Financial Management Division.

Mr. Houlihan is over to my left and the other gentlemen are behind me. I think you know Ms. Kent of the Treasury Department.

APPROPRIATION REQUEST

The pending appropriation request for fiscal year 1987 totals $307,140,000, an increase of $13,140,000 when compared with the enacted level for fiscal year 1986 of $294,000,000. This net increase reflects program increases of $16,537,000, maintaining current level cost increases of $4,845,000, a reduction of $4,582,000 to the equipment base, and a $3,660,000 decrease in counterterrorism funds.

The Service's fiscal year 1986 budget is $281,358,000 following mandated Gramm-Rudman-Hollings sequestration.

CONTINUED INCREASE IN ACTIVITIES

The past year has shown a continuing increase in the activities of the Secret Service.

During fiscal year 1985, we provided security to permanent protectees traveling extensively throughout the United States and abroad, and to foreign leaders visiting the United States. Fiscal year 1985 can be appropriately described as a year of global unrest impacting on U.S. citizens and potentially threatening U.S. officials; thus, placing greater demands on the Secret Service than ever before. Therefore, unprecedented protective measures required in fiscal years 1985 and 1986 will have to be continued and expanded in fiscal year 1987 for our permanent protectees, visiting foreign dignitaries, and foreign missions.

Mounting investigative responsibilities have also placed greater demands on the Secret Service. Credit and debit card fraud investigations have increased by 1,100 percent from fiscal year 1984 to 1985.

Increasingly sophisticated methods of counterfeiting credit cards and accessing account numbers will require even more investigative resources in fiscal year 1987.

The Secret Service similarly does not anticipate any declines in traditional areas of investigation, such as counterfeiting, check and bond forgery, and protective research cases.

PROTECTIVE EFFORT

As in the past, protective responsibilities in fiscal year 1985 entailed numerous travel days, man-hours, and a consummate effort from the Service's entire protective force. Protective man-hours worked in fiscal year 1985 proved to be the highest ever for a noncampaign year.

With the close of the 1984 Presidential campaign, our protective effort continued with the planning of the Presidential inauguration. Adding to our overall protective program was the enormous responsibility associated with planning and executing protection for the United Nation's 40th General Assembly.

Special agents from all over the country were called upon to cope with the breadth of this event. During the period of late September 1985 to October 30, 1985, over 100 heads of state or government visited New York City for this event. During the week of October 20, 57 Secret Service protectees were in New York, at one point in time.

The challenges associated with this event were made even greater with the additional security measures necessary to deter possible terrorist actions against such a large gathering of world leaders. We were greatly aided in supplying the necessary security forces by personnel from the other Treasury bureaus, Federal law enforcement agencies, and State and local governments. I would like to commend these men and women for their outstanding support.

UNIFORMED DIVISION

The U.S. Secret Service Uniformed Division is mandated to protect the Executive Mansion and grounds, the New Executive Office Building, diplomatic missions located in the Washington metropolitan area, and occasionally missions located outside this area. Uniformed Division protection is also integrated with that for the President, the Vice President and their residences, and members of their immediate families.

Uniformed Division responsibilities will expand in the near future with the addition of new magnetometer posts at the White House complex. The use of the magnetometer details has proven to be an effective means of detecting weapons carried in the vicinity of a protectee.

FIELD OFFICES

Special agent personnel from the Secret Service's field offices spent a large portion of their duty hours supporting protective functions in fiscal year 1985. In 1985, 58 percent of all special agent man-hours was devoted to protection, with field office personnel contributing substantially to this effort.

Much of this work involved conducting advance surveys for visiting protectees and providing physical protection for incoming permanent and temporary protectee details.

In addition to the heavy reliance upon the Service's investigative personnel for protective reinforcement, substantial hours were spent in protective related investigations. Cases closed totaled 13,426 in fiscal year 1985, with 709 arrests, 606 convictions, and 254 cases pending for court action. Despite the heavy commitment of investigative manpower to protection, the personnel in our field offices maintained a high level of criminal enforcement during fiscal year 1985.

OVERALL INVESTIGATIVE CASELOAD

Overall, the Secret Service's investigative caseload continues to increase. Investigations received in 1985 totaled 208,642, an increase of 2,421 over the previous year. Estimates of cases to be received in fiscal year 1986 exceed our fiscal year 1985 statistics by 9 percent. A strong increase is expected in fiscal year 1987. The Secret Service closed 198,922 investigations in fiscal year 1985, an approximate increase of 10,000 cases over fiscal year 1984.

ACCESS DEVICE FRAUD INVESTIGATIONS

The Secret Service's new responsibilities involving credit and debit card fraud required a significant reallocation of investigative resources during fiscal year 1985.

The Secret Service has recently seen a tremendous increase in fraudulent telemarketing operations which have accounted for the loss of millions of consumer dollars. All indications point to a continuation of this trend.

EQUAL EMPLOYMENT OPPORTUNITY

The Service has continued to pursue a vigorous program for the recruitment of qualified minority employees, as well as a program to prepare minority clerical employees for advancement into administrative and technical positions.

As you know, the Service has a special need for minorities in the ranks of our special agents and uniformed officers. Accordingly, we have conducted significant recruitment efforts for these categories of personnel so that we can compete with private industry for qualified minorities. A record number of minority applicants were hired as special agents in fiscal year 1985. Approximately 29.9 percent of all special agents hired were from a minority group.

SUMMARY

In summary, Mr. Chairman, fiscal year 1985 was a successful but demanding year for the Secret Service in which our greatest concern was upgrading security measures to cope with the increasing terrorist aggression surrounding us. The safety of our protectees must always be the Service's first priority, and it requires an increasingly higher level of effort and resources. As a result, more manpower was expended in protective activities in fiscal year 1985 and our technical capabilities reached new levels of sophistication. Budgeted resources are carefully apportioned to law enforcement programs and positions while maintaining an extremely lean support staff. In that respect, fiscal year 1985 can be looked upon as a transition year; one which should set a precedent for meeting future protective demands.

I am extremely grateful for this committee's understanding and support for the Secret Service in the past. I would also like to acknowledge the supreme efforts of the Secret Service employees who possess the individual pride and concern and that professionalism which produces an outstanding team effort. This same intense, dedicated effort from our agency will continue in the future.

PREPARED STATEMENT

Mr. Chairman, this concludes my statement. I will be pleased to answer any questions that you or the other members of the committee may have.

[The statement follows:]

STATEMENT OF JOHN R. SIMPSON

Mr. Chairman, I am pleased to appear before you and the other members of this Committee to present the annual appropriation request of the United States Secret Service and to report on our activities during the current and past fiscal years.

Introduction of Associates

With me today, Mr. Chairman, is the Deputy Director, Mr. Larry B. Sheafe, Mr. David C. Lee, Assistant Director for Administration, Mr. Stephen E. Garmon, Assistant Director for Protective Operations, Mr. Joseph R. Carlon, Assistant Director for Protective Research, Mr. Kevin R. Houlihan, Assistant Director for Investigations, and Mr. Frank Palmer, Chief of our Financial Management Division. Since this is the first appearance before this committee of Messrs. Lee and Houlihan, with your permission I would like to insert a short biographical sketch of each for the record.

David C. Lee

David C. Lee was appointed Assistant Director of the Office of Administration on February 16, 1986. Prior to this appointment, he held the position of Deputy Assistant Director of the Office of Administration.

Mr. Lee was born July 19, 1941, in Boston, Massachusetts. He received a bachelor of arts degree in economics from Boston College in 1963. Mr. Lee served in the United States Army Reserve from 1964 to 1968.

David Lee was appointed a special agent at the Boston Field Office in 1965. Since his appointment, Mr. Lee has gained extensive experience in investigative and protective work while assigned to various field offices and protective divisions. Mr. Lee was promoted to Assistant to the Special Agent in Charge of the Dignitary Protective Division in 1978. While assigned to the Dignitary Protective Division, he served as Deputy Inspector in Charge and Acting Inspector in Charge of the Candidate Nominee Protective Division from September 1979 to November 1980. In 1981, Mr. Lee left the Dignitary Protective Division to serve as an inspector in the Office of Inspection. He was promoted to

Assistant Special Agent in Charge of the Washington Field Office less than a year later.

In 1984, Mr. Lee was appointed Special Assistant in the Office of the Director. He was promoted to Deputy Assistant Director of the Office of Administration in 1985, where he remained until receiving his current appointment.

David Lee is a participating member of the International Association of Chiefs of Police and is on the Board of Directors at the Center for the Handicapped, Inc.

Kevin R. Houlihan

Kevin R. Houlihan was appointed Assistant Director of the Office of Investigations on September 1, 1985. Prior to this appointment, Mr. Houlihan held the position of Deputy Assistant Director of the Office of Investigations.

Mr. Houlihan was born February 2, 1942, in Queens, New York. He attended St. John's University in New York and received a bachelor of science degree in business administration in 1963. He also served in the United States Marine Corps from 1963 to 1966.

Kevin Houlihan was appointed a special agent at the New York Field Office in August 1967. Since his appointment, he has worked on a variety of protective and investigative assignments.

Mr. Houlihan was reassigned to the position of resident agent of the Portland Resident Agency in 1974. Two years later, he was promoted and served in the position of Assistant to the Special Agent in Charge in both New York, and Chicago. Mr. Houlihan was promoted and transferred to the Service's Office of Inspection in 1980. After three years, he was promoted and appointed Assistant to the Director for the Office of Training. Kevin Houlihan became Deputy Assistant Director for the Office of Investigations on March 3, 1985, where he remained until receiving his current appointment.

Retirement of Former Deputy Director William R. Barton

As you are aware, former Deputy Director William R. Barton recently retired after 32 years of distinguished service with the

United States Secret Service. I would like to take this opportunity to express my appreciation for a job well done and to wish him well in the future.

Appropriation Request

The pending appropriation request for Fiscal Year 1987 totals $307,140,000, an increase of $13,140,000 when compared with the proposed authorized level for Fiscal Year 1986 of $294,000,000. This net increase reflects Program Increases of $16,537,000, Maintaining Current Level cost increases of $4,845,000, a reduction of $4,582,000 to the equipment account, and a $3,660,000 decrease in counterterrorism funds.

The Service's Fiscal Year 1986 budget is $281,358,000 following mandated Gramm-Rudman-Hollings' sequestration.

As in the past, protective responsibilities highlighted Fiscal Year 1985. Considerable time and effort were expended in the planning of the Presidential Inauguration. Protective manpower was heavily utilized at the United Nations General Assembly 39 and especially the United Nations General Assembly 40. The latter event was attended by more than 100 Heads of State and foreign dignitaries requiring Service protection. Coordination of details and logistics associated with United Nations General Assembly 40 proved to be the largest protective assignment in Secret Service history.

Continued Increase in Activities

The past year has shown a continuing increase in the activities of the Secret Service. During Fiscal Year 1985, we provided security to permanent protectees traveling extensively throughout the United States and abroad, and to foreign leaders visiting the United States. Fiscal Year 1985 can be appropriately described as a year of global unrest impacting U. S. citizens and potentially threatening U. S. officials; thus, placing greater demands on the Secret Service than ever before. Terrorism continued to grow, both in its violent nature and scope. A recent Rand Corporation study entitled "The Future Course of International Terrorism" estimates this growth rate to be 12 to 15 percent annually. Despite these projections, the Secret Service foresees increased protectee travel abroad and substantial off-year campaign travel in Fiscal Year 1987. Therefore, the unprecedented protective measures required in Fiscal Years 1985 and 1986 will have to be continued and expanded in Fiscal Year 1987 for our permanent protectees, visiting foreign dignitaries, and foreign missions.

Mounting investigative responsibilities have also placed greater demands on the Secret Service. Credit and debit card fraud investigations have increased by 1,100 percent from Fiscal Years 1984 to 1985. Increasingly sophisticated methods of counterfeiting and accessing credit cards and accessing account numbers will require even more investigative resources in Fiscal Year 1987. The Secret Service similarly does not anticipate declines in traditional areas of investigation such as counterfeiting, check and bond forgery, and protective research cases.

Protective Effort

As in the past, protective responsibilities in Fiscal Year 1985 entailed numerous travel days, manhours, and a consummate effort from the Service's entire protective force. Protective manhours worked in Fiscal Year 1985 proved to be the highest ever for a non-campaign year.

With the close of the 1984 presidential campaign, our protective effort continued with the planning of the Presidential Inauguration. Adding to our overall protective program was the enormous responsibility associated with planning and executing protection for the United Nation's 40th General Assembly. Special agents from all over the country were called upon to cope with the breadth of this event. During the period of late September 1985 to October 30, 1985, over 100 Heads of State or government visited New York City for this event. During the week of October 20th, 57 Secret Service protectees were in New York.

The challenges associated with this event were made even greater with the additional security measures necessary to deter possible terrorist actions against such a large gathering of world leaders. We were greatly aided in supplying the necessary security forces by personnel from other Treasury bureaus, Federal law enforcement agencies, and State and local governments. I would like to commend these men and women for their outstanding support.

Travel increased dramatically and remained steady throughout Fiscal Year 1985 and early 1986 while major protective events such as the United Nations General Assembly 40, the Geneva Summit, and the International Monetary Fund Meeting continued to test the efficiency and fortitude of our employees. Because of the effort and expert performance by all Service personnel, Fiscal Year 1985 was an overall success for the Secret Service in accomplishing its protective mandates.

Permanent Protection

In Fiscal Year 1985 the Secret Service's permanent protectees included President Reagan and Mrs. Reagan, and members of their family; Vice President and Mrs. Bush; former Presidents Carter and Ford and their spouses; former President Nixon until July 1, 1985; former First Lady Johnson, Chief of Staff Donald Regan, and Secretary of Treasury James A. Baker. These protectees traveled to 3,387 domestic and 193 foreign cities in 1985, both substantial increases over Fiscal Year 1984.

Uniformed Division

The U. S. Secret Service Uniformed Division is mandated to protect the Executive Mansion and grounds, the New Executive Office Building, diplomatic missions located in the Washington metropolitan area, and occasionally missions located outside this area. Uniformed Division protection is also integrated with that for the President, the Vice President and his residence and members of their immediate families.

Activity was exceptionally heavy in Fiscal Year 1985 for the Uniformed Division Magnetometer details. Screening persons in the vicinity of selected Secret Service protectees continued to be an effective program for uncovering weapons and deterring potentially harmful individuals from approaching protectees. The Uniformed Division's hard work is evidenced by the 1,484,155 individuals processed by magnetometer details. Our White House Branch also conducted tours for 1,115,756 visitors to the White House.

The Uniformed Division Foreign Missions Branch responded to numerous activities in 1985, including the coverage of 203 Embassy receptions, 690 demonstrations, and 410 Embassy or White House alarms. A total of 1,085 events received protective reinforcement from our Counter Sniper Unit, a comparable level to 1984 but a substantial total for a non-campaign year. Support to the Service's protective details was also provided by the Canine Explosive Detection Program.

Uniformed Division responsibilities will expand in the near future with the addition of new magnetometer posts at the White House complex. The use of the magnetometer details has proven to be an effective means of detecting weapons carried in the vicinity of a protectee.

Treasury Police Force

The Treasury Police Force, another uniformed branch of the Secret Service, is charged with the responsibility of protecting life and property at the Main Treasury Building and the Treasury Annex in Washington, D.C., in addition to providing assistance in various other assignments. This past year, Treasury Police Force personnel arrested 16 individuals, were involved in 12 protective intelligence cases and 39 criminal cases. The Force provided manpower for 201 Presidential security details and 1,064 escort details. Because security for the main Treasury building forms an integral part of overall White House protection the Secret Service is continuing efforts to incorporate this facility under the White House Complex protective umbrella per recommendations in a recent study regarding security at this location. Additional enhancements have already been instituted at the Treasury Department Complex in an effort to upgrade security.

Protection of Foreign Heads of State or Government

In 1985 the Secret Service assigned security details to 139 visiting foreign dignitaries and Heads of State. Protection of foreign VIP's included these annual events: the United Nations General Assemblies, the Caribbean Conference in Miami, and the International Monetary Fund Meeting in Washington, D.C.

Providing a secure environment for our foreign visitors continues to be one of the Secret Service's highest priorities. This effort requires more protective and planning resources each year as visits continue to increase. In addition, National Security Directive 207, signed by the President in January 1986, provides that the Secretary of Treasury, by May 1, 1986, extend Secret Service protection to accompanying spouses of visiting heads of state. The Statue of Liberty Celebration will take place in July of Fiscal Year 1986. During Fiscal Year 1987 attendance by foreign dignitaries is expected at the annual events mentioned above, and the Pan American Games in Indianapolis. Additionally, Pope John Paul II will visit the U. S. in the spring of 1987.

Pan American Games

The Secret Service is committed to a successful protective effort for the 1987 Pan American Games in Indianapolis. The Service expects a number of Foreign dignitaries and permanent protectees to visit the games.

Candidate/Nominee

Election years are always major tests for the Secret Service's protective forces. Planning, implementing coordinating centers, and setting up communications equipment will be vital preliminary steps which require substantial effort from special agent and support personnel. In Fiscal Year 1987, these areas must be addressed so that the 1988 campaign details can operate smoothly. Preparation will therefore begin in Fiscal Year 1987 with extensive training of Secret Service and other Treasury agents who are needed to support our campaign effort. Communications equipment will be placed at coordinating centers, further drawing upon our resources. These tasks will begin in the summer of 1987 and more than likely compete with the off-year election campaigning by permanent protectees. Fiscal Year 1987 should prove to be an enormous challenge for the Secret Service, but one that will have a strong impact on the 1988 campaign.

Assistance of Other Federal, State, and Local Law Enforcement Agencies

Without the steady assistance of personnel from local, state and other Federal law enforcement agencies, fulfilling the Secret Service's mission would be extremely difficult. The support of these groups has been constant, cooperative and unselfish, allowing the Secret Service to provide the highest level of protection possible.

Field Offices

Special Agent personnel from the Secret Service's field offices spent a large portion of their duty hours supporting protective functions in Fiscal Year 1985. In 1985, fifty-eight percent (58%) of all Special Agent manhours was devoted to protection, with field office personnel contributing substantially to this effort. Much of this work involved conducting advance surveys for visiting protectees and providing physical protection for incoming permanent and temporary protectee details.

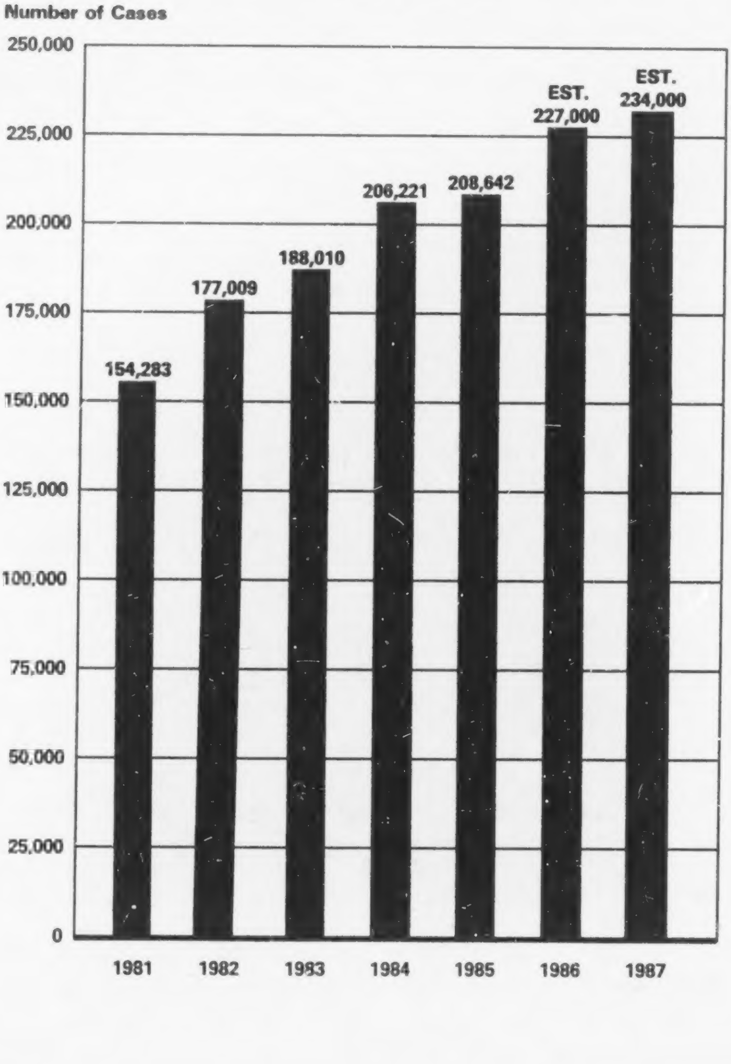
In addition to the heavy reliance upon the Service's investigative personnel for protective reinforcement, substantial hours were spent in protective related investigations. Cases closed totaled 13,426 in Fiscal Year 1985, with 709 arrests, 606 convictions and 254 cases pending for court action. Despite the heavy commitment of investigative manpower to protection, the personnel in our field offices maintained a high level of criminal enforcement during Fiscal Year 1985.

Overall Investigative Caseload

Overall, the Secret Service's investigative caseload continues to increase. Investigations received in 1985 totaled 208,642, an increase of 2,421 over the previous year. Estimates of cases to be received in Fiscal Year 1986 exceed our Fiscal Year 1985 statistics by nine percent. A strong increase is expected in Fiscal Year 1987. The Secret Service closed 198,922 investigations in Fiscal Year 1985, an approximate increase of 10,000 cases over Fiscal Year 1984. The chart on the next page shows the total cases received for investigation over the past five years, as well as the most recent estimates of the number to be received in Fiscal Year 1986 and 1987 (Chart A).

Chart A

Total Cases
Received for Investigation
Fiscal Years 1981 - 1987



Access Device Fraud Investigations

The Secret Service's new responsibilities involving credit/debit card fraud required a significant reallocation of investigative resources during Fiscal Year 1985. Credit and debit card fraud cases received by the Service in 1985 increased 1,100 percent over Fiscal Year 1984. Investigations into the fraudulent use of credit card account numbers increased from one in 1984 to 628 in 1985. Counterfeit credit card investigations increased from 117 to 559. A total of 584 individuals were arrested, 40,000 counterfeit credit cards were seized, and 100,000 lost, stolen and altered access devices were recovered in 1985. The Secret Service has recently seen a tremendous increase in fraudulent telemarketing operations which have accounted for the loss of millions of consumer dollars. All indications point to a continuation of this trend. In just the first quarter of Fiscal Year 1986, the Secret Service made 408 arrests involving access devices and seized devices with a fraud value in excess of $72 million. These potential losses are based on industry estimates.

The Access Device Fraud jurisdiction will continue to expand in 1987 with the development of a program for the detection and enforcement of Federal law violations in connection with civilian credit agency computer systems.

Counterfeiting Activities

In Fiscal Year 1985, both arrests (1,738) and convictions (1,591) for counterfeiting exceeded Fiscal Year 1984, despite the reallocation of manpower to handle new investigative jurisdictions. Counterfeiting arrests in 1985 exceeded the previous year's total by 159.

Counterfeit notes seized before being passed to the public totaled $61.7 million, a decline from 1984 which was a record year for currency seized. A total of $6.9 million was recovered after being passed on to the public. One hundred and five counterfeiting plants were also suppressed.

Efforts to suppress counterfeiting overseas have also been expanded with the establishment of the Milan, Italy Field Office. This office will provide the Service with a permanent and cost-effective deterrent to foreign counterfeiting originating in Italy. The Far East Anti-Counterfeiting Task Force recently concluded with several arrests and a plant suppression. This operation had produced the most deceptive counterfeit $100 Federal Reserve Note ever encountered by the Secret Service and was culminated following an 18 month investigation. This operation had originated 14 years earlier in Hong Kong B.C.C. Given the deceptive nature of the notes involved, counterfeit money from this ring had been successfully passed throughout the entire Far East, Middle East, Europe, Canada, and numerous cities in the United States. The Secret Service is presently continuing to explore the possibility of establishing additional foreign field offices.

The following charts (Fiscal Years 1981 to 1985) show the dollar value of counterfeit notes seized before circulation, the overall losses to the public, and the number and dollar value of counterfeit notes passed (Charts B and C).

Check Forgery

Check forgery and check-related crimes remain a major investigative area for enforcement. Check forgery cases received decreased from 115,455 in Fiscal Year 1984 to 92,373 in Fiscal Year 1985. However, arrests of individuals during the same period rose from 3,862 to 5,403, a 40 percent increase.

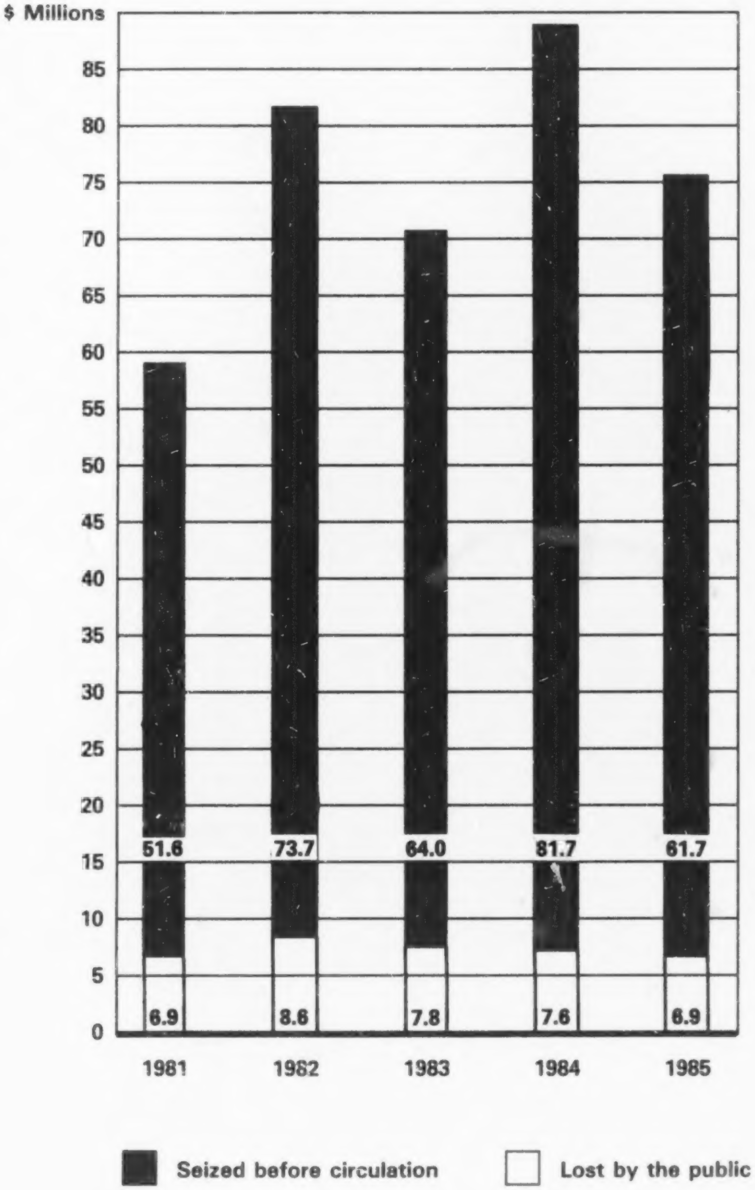
Once forged checks are discovered, they are subjected to technical analysis of handwriting/endorsements by the Forgery Division, and compared with previously received forged checks.

United States Secret Service

Counterfeiting Activity

Fiscal Years 1981 - 1985

Chart B

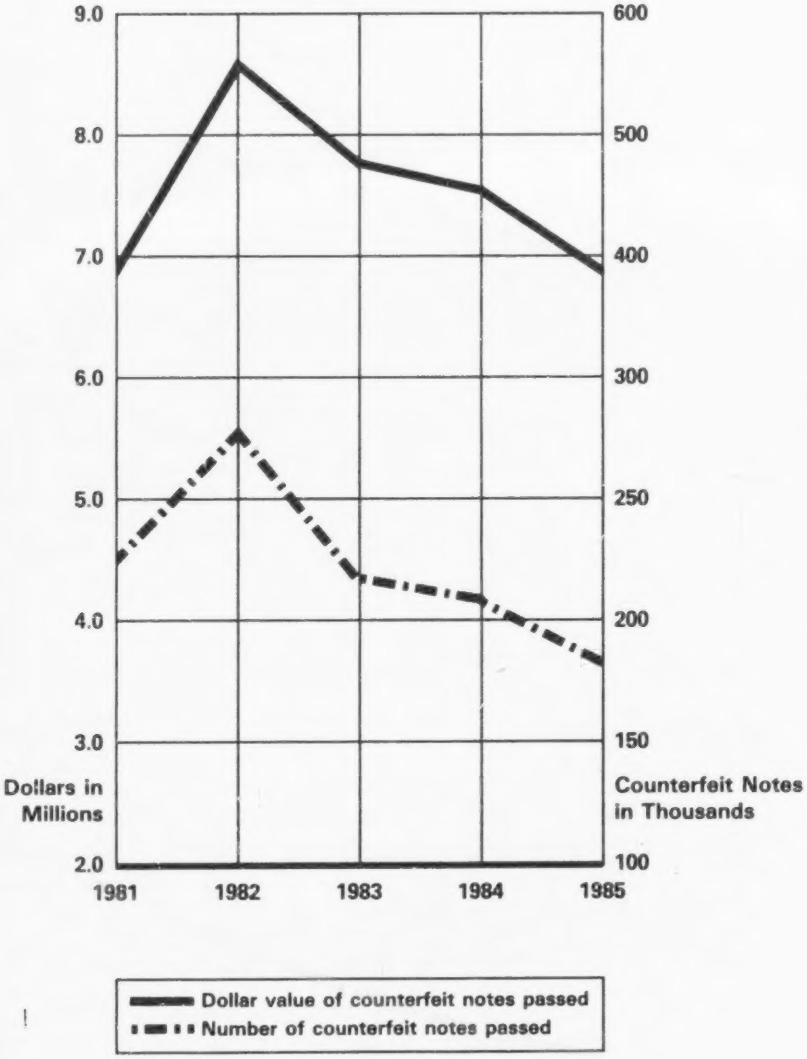


United States Secret Service

Chart C

Counterfeiting Trends

Fiscal Years 1981 - 1985



Noted similarities are then used to associate these checks with known or unidentified check forgers.

In Fiscal Year 1985 the Secret Service led a worldwide investigation involving large quantities of forged U. S. Treasury checks which had been stolen from the mails in the San Francisco area, transported to the Philippines for alteration, and then fenced throughout the world for negotiation. To date, it is estimated that well over 100 million dollars worth of these altered checks had been negotiated or siezed by authorities prior to successful negotiation. This single investigation uncovered the largest total dollar value for forged checks in Secret Service history. The trail of altered/forged checks had led from Southeast Asia to the Pacific, Central America, Africa, Europe, the Mid-East and Asia.

The following chart reflects the number of check cases received for investigation for Fiscal Years 1981 through 1985 with estimates for Fiscal Years 1986 and 1987 (Chart D).

Bond Forgery

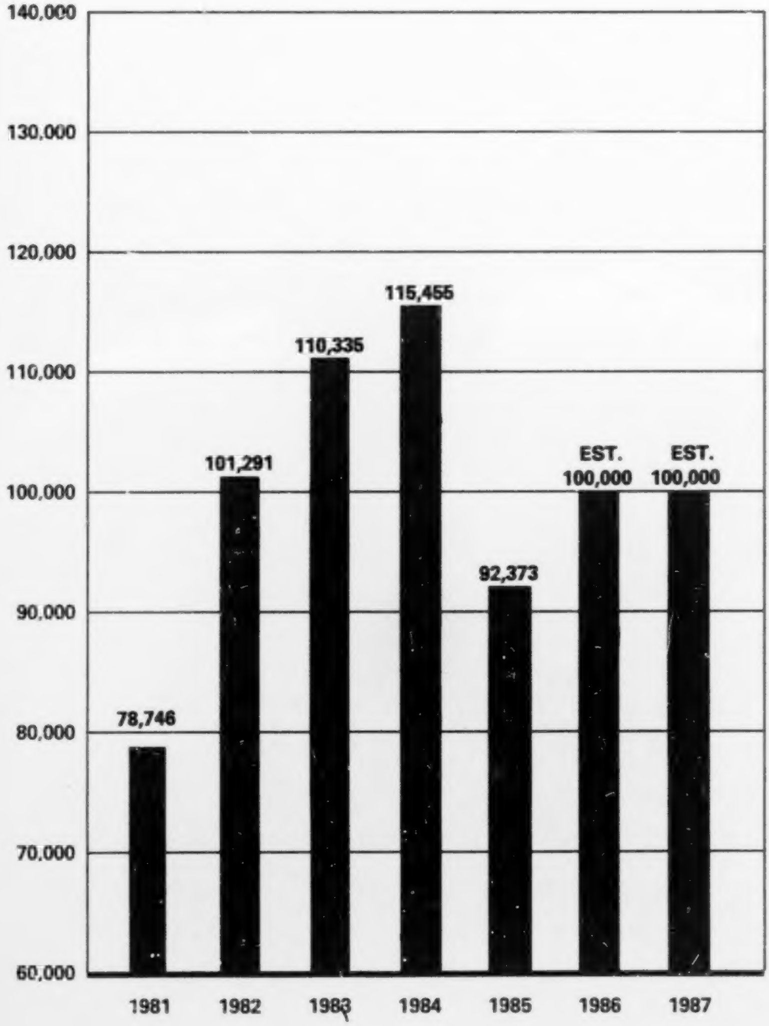
Investigations received for bond forgery cases decreased from 7,003 in Fiscal Year 1984 to 5,420 in Fiscal Year 1985. Bond violation arrests increased from 61 to 117 during the same period. Additionally, 3,314 referred bonds were analyzed in terms of handwriting/endorsement by the Forgery Division and compared with previously received bonds. Twenty-nine percent of these bonds were associated, through handwriting analyses, with previous forgers who were either known or unidentified.

The following chart details bond forgery cases received for investigation from Fiscal Years 1981 through 1985, with estimates for Fiscal Years 1986 and 1987 (Chart E).

United States Secret Service Chart D

Number of Forged Check Cases Received for Investigation

Fiscal Years 1981 - 1987

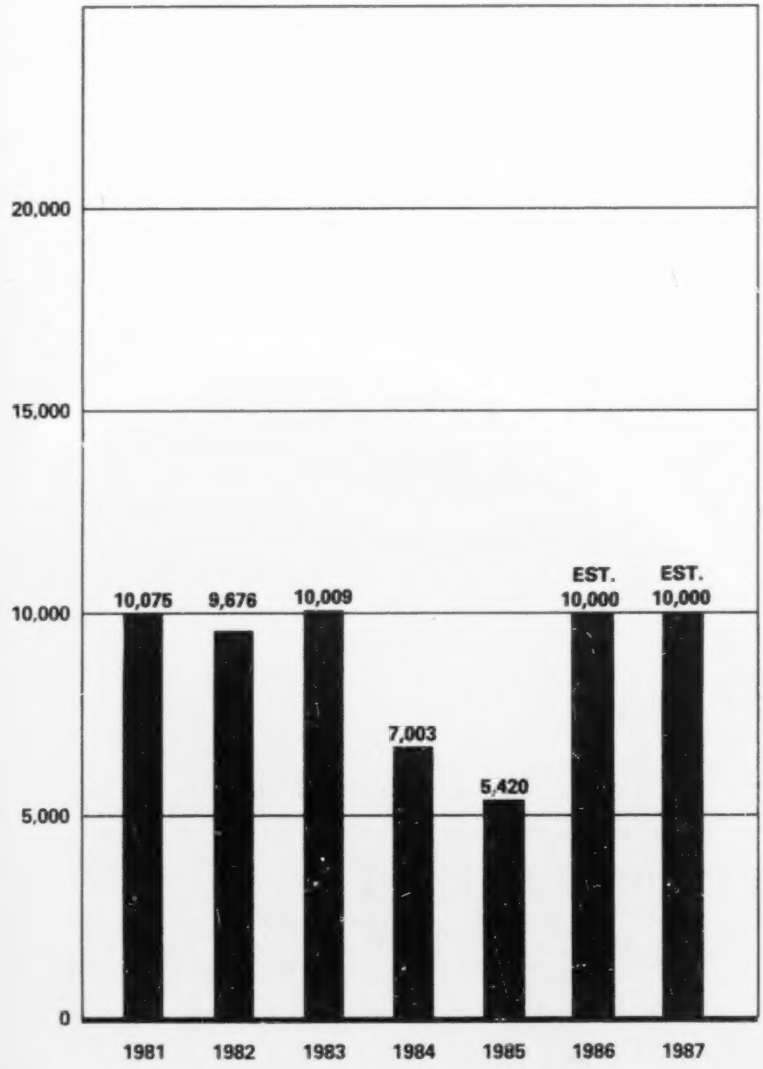


United States Secret Service

Chart E

Number of Forged Bond Cases Received for Investigation

Fiscal Years 1981 - 1987



Computer Fraud

On October 26, 1982, Department of Treasury Order No. 170-1 was signed authorizing the Secret Service to receive and analyze allegations of, and develop information and conduct investigations concerning thefts and frauds involving electronic transfer of funds (a) which belong to the Treasury Department or a subsidiary agency; (b) for which the Treasury Department or any subsidiary agency may be responsible or liable; or (c) with respect to which the Department or any subsidiary agency may otherwise have, or have to defend against, a civil claim of any type. In October of 1984, 18 U.S.C. 3056 was amended to authorize the Secret Service to "detect and arrest any person who violates any of the laws of the United States relating to electronic fund transfer frauds..."

Direct Deposit and Electronic Funds Transfer Investigations totalled 7,916 in Fiscal Year 1985, a decrease from Fiscal Year 1984, but an approximate 3,500 increase over 1983, which was the first year of the program. Undoubtedly, this jurisdiction will require more resources in the future as the Secret Service learns more about counteracting the sophisticated tactics and techniques associated with this form of computer fraud.

Organized Crime

The Secret Service continues to participate in the Organized Crime Strike Force Program of the Department of Justice and is an active member of the National Organized Crime Planning Council, which consists of members of Federal law enforcement agencies. The Council visits the various strike forces throughout the country and gathers information concerning organized crime activities. At present, the Secret Service has designated 14 Organized Crime Strike Force representatives in our field offices who coordinate their efforts with the national representative assigned to headquarters.

Visits by the Council to the strike force districts have renewed enthusiasm and interest in the program. Our strike force representatives report that inter-agency cooperation has improved and, as a result, information that otherwise would not have been received has become available, proving beneficial to our investigative activities.

Operational Balance

Resources must first be devoted to our protective programs since this is the highest priority in the Secret Service. However, the goal of the Secret Service is to promote a balance between investigative and protective duties. Therefore, the Service's expanding investigative jurisdictions have complemented our escalating protective duties. Moreover, this balance requires maximum effort and flexibility on the part of our special agents. We have found that investigative responsibilities provide the special agent with an important sense of awareness, sharp instincts and observational qualities which are absolutely vital to producing a maximum protective effort. Improvement of all of these areas gives the special agent a keen sense of his and her protectee's environment. This balance of duties (investigation and protection) will continue to form an integral element of our protective strategy in the future.

Protective Research

Enhancement of security in the White House Complex continued during FY 1985. This included the fabrication and installation of more crash resistant gates. Electronic and other systems were also developed and implemented in support of the Service's overall protective and investigative missions. These included the new First Family locator system, a new generation of portable weapons detectors and the fabrication and delivery of several alarm systems. In Fiscal Year 1987 this office will finalize research studies for a specialized counterterrorist detection system which will integrate existing civilian operational systems with newly developed military systems. An upgrading and modernization of our armored car program was also a significant accomplishment in Fiscal Year 1985. These upgrades are urgent and necessary projects given the imminent danger to vehicular movements posed by terrorists. Implementation of advanced countermeasure techniques, new armoring options and state-of-the-art detection systems are planned for Fiscal Years 1986 and 1987.

Since the beginning of this decade, the Secret Service has been involved in planning and implementing an organization-wide ADP modernization program. The program includes: creating centrally supported databases; upgrading mission-support computer applications for front-line users; replacement of our mainframe computer systems along with splitting mainframe locations between headquarters and an alternate site; acquisition of standard multi-purpose workstations; implementation of a nation-wide network to interconnect all Secret Service locations electronically; and participation in the Treasury digital PBX project for Washington area users.

Although some initiatives will be ongoing, we expect to complete all of the critical portions of the ADP modernization program that will be required to support the 1988 Presidential Election Campaign, which will get underway at the end of fiscal year 1987.

The Communications Division was involved with several projects in Fiscal Years 1985 and 1986, including providing general support and over one thousand pieces of communications equipment for the United Nations General Assembly.

Training

The Office of Training followed Fiscal Year 1984's heavy campaign training schedule with a productive year in 1985, marked by an increase in daily training scenarios and training methods. One hundred and nine newly appointed special agents were trained in all phases of Secret Service responsibilities. Advance protection and protection-related subjects were taught to 431 special agents during special protective detail seminars. Through Dignitary Protection seminars and Protective Operations briefings, over 1,000 Federal, state, and local police officers received training in Secret Service protective procedures.

Preparation for the 1988 campaign will begin during Fiscal Year 1987, encompassing the latest training techniques for special agent personnel. Courses will be developed and implemented for Detail Supervisors, Advance Agents, and operations and support personnel. Candidate details will also be planned. Courses for the training of Treasury Department agents to be called upon for campaign assistance will also go into effect.

Training of uniformed officers in Fiscal Year 1985 included the completion of four Uniformed Division Officer in-service training classes. Three Uniformed Division recruit classes graduated 71 officers. An independent review of the Canine Training Program was also conducted in March of 1985 and the Secret Service's program was found to be stable. Uniformed officer training in Fiscal Year 1987 will include the implementation of a fully integrated training program for all protective elements. Additionally, weapons and law-enforcement equipment will be tested and evaluated to insure that they meet advanced technological standards.

Development of the James J. Rowley Training Center remains an urgent priority for the Secret Service in terms of eventual completion of the master plan. This progression depends on available resources. In Fiscal Year 1986, detailed construction design plans will be readied for the Security and Computer Building, Protective Driver Training Course and a simulated airport apron. After completion of this phase in early Fiscal Year 1987 a contract for construction of these features is expected to be awarded in the spring of 1987. Further development of the plans for completion of the Master Plan project will continue to be developed as resources permit.

Equal Employment Opportunity

The Service has continued to pursue a vigorous program for the recruitment of qualified minority employees, as well as a program to prepare minority clerical employees for advancement into administrative and technical positions. As you know, the Service has a special need for minorities in the ranks of our special agents and uniformed officers. Accordingly, we have conducted significant recruitment efforts for these categories of personnel so that we can compete with private industry for qualified minorities. A record number of minority applicants were hired as special agents in Fiscal Year 1985. Approximately 29.9 percent of all special agents hired were from a minority group.

Extensive efforts were made during Fiscal Year 1985 in cities where we could gain access to designated minority groups. We processed over 1,644 applications from these recruitment groups for special agent and uniformed officer positions and intend to continue in this vitally important endeavor.

Freedom of Information and Privacy Acts

During Fiscal Year 1985, the Service processed 537 Freedom of Information requests and 124 Privacy Act requests. Additionally, our Chief Counsel processed 51 FOI administrative appeals and actively assisted in the litigation of eight judicial appeals. Since the passage of the Freedom of Information and Privacy Acts in 1974, the Service has spent in excess of $300,000 each year in responding to the numerous requests. In Fiscal Year 1985, direct expenses associated with processing FOI and Privacy Act requests amounted to $233,000. Of this amount, less than one-half of one percent is potentially recoverable through FOI/Privacy Act billings. The actual amount recovered amounted to approximately one-tenth of one percent.

Summary

In summary, Mr. Chairman, Fiscal Year 1985 was a successful but demanding year for the Secret Service in which our greatest concern was upgrading security measures to cope with the increasing terrorist aggression surrounding us. The safety of our protectees must always be the Service's first priority, and it requires an increasingly higher level of effort and resources. As a result, more manpower was expended in protective activities in Fiscal Year 1985 and our technical capabilities reached new levels of sophistication. In that respect, Fiscal Year 1985 can be looked upon as a transition year; one which should set a precedent for meeting future protective demands.

I am grateful for this Committee's understanding and support for the Secret Service in the past. I would also like to acknowledge the supreme efforts of our Secret Service employees who possess the individual pride and concern that produces an outstanding team effort. This same intense, dedicated effort from our agency will continue in the future.

Mr. Chairman, this concludes my statement. I will be pleased to answer any questions you or the other members of the Committee may have.

GRAMM-RUDMAN-HOLLINGS

Senator ABDNOR. Fine. Thank you. I again want to commend you for the fine organization and the work you do.

One question that I would ask all our agencies is how the Gramm-Rudman-Hollings cuts affect your agency. I think you touched on it, but what has that meant to you? What have you had to do to comply with it?

Mr. SIMPSON. It meant postponement, that is, a deferrence of some programs in some areas where we would normally have spent money. For instance, we had to make some rather drastic cuts in the area of police-type vehicles. We were not able to buy any at all for 1986.

As you know, we are an organization that is 80 percent labor intensive in terms of the distribution of appropriated funds to the areas of personnel compensation, travel, rent, and utilities. That does not give us an awful lot of equipment money nor any other types of money to take care of those mandatory cuts.

I think that we are in a position now, hopefully, that Gramm-Rudman will not impact the 1987 budget as it did in 1986. Given the proposed $307 million fiscal year 1987 request, and hopes to stay there, I think we will be in good shape to conduct our business in a manner that I think you and the American public would be pleased with.

Senator ABDNOR. We are not very sure of this, John, but, as you know, last night the Budget Committee passed some budget. Of course, it is still unknown to a lot of us, but we have had a little glimpse of it. And I think a great many of the domestic programs are frozen at the 1986 level. I do not know whether that means with Gramm-Rudman out of it, or frozen at the old figure with Gramm-Rudman in it.

Mr. SIMPSON. All I can say to you, Mr. Chairman, is that frozen either before or after Gramm-Rudman, it would not do for us. As I mentioned to you, we postponed many of the normal operating expenses and replacement items that we would normally acquire this year to meet the sequestration mandated by Gramm-Rudman-Hollings. We would not be able to handle that in 1987. The budget that was given to us through the Treasury and Office of Management and Budget [OMB] is a good budget for us.

EQUIPMENT REDUCTION

Senator ABDNOR. We had better have you give us for the record a detailed accounting of what you would have to do if this budget went into place. What would happen if you had to freeze it at the 1986 level? It might help us as we go along here. That puts a damper on all questions we might ask. What we put together was based on what we thought, and I am trying to put together some facts on it.

Maybe we will know in a day or two.

The budget indicates your equipment base will be reduced, that is the budget you have here now. What will you do, hold off buying your equipment?

Mr. SIMPSON. We will have to hold off buying at this point in time. However, to understand that budget reduction that you see, you have to trace back another year. There were certain individuals who felt very strongly that our budget, particularly our equipment area, was a little bit, shall I say, overweight, which was hardly the case. Nevertheless, I was not able to make a good enough case. At the present time, I think Treasury and OMB have come through with a replacement of the cuts that we took in Gramm-Rudman so that we will be able to buy equipment, assuming that what you just described does not take place. We are still going to be behind, but that is not a situation that people now on board are responsible for.

Over the years you have been supportive of us and the other law enforcement bureaus. I am sure, even though there might be a new budget bill up here for consideration you will be a good advocate for law enforcement, as you have been in the past.

REDUCTION OF COUNTERTERRORISM FUNDS

Senator ABDNOR. Well, we certainly have a great appreciation for it. We wish everyone on the committee was as close to doing it as we were here in this committee in working with you and the other law enforcement agencies. But we will just have to hope for the best. It is a long ways from being adopted, but they are going to try to pass a Senate budget bill before we leave for Easter recess. It is going to be interesting in the days ahead.

I think they will probably take it up next week.

Well, your budget shows a reduction of $3,660,000 for counterterrorism in fiscal year 1987. Are these the funds that we authorized in fiscal year 1986, and, if so, why are you showing these costs as nonrecurring?

Mr. SIMPSON. The problem was in the timing of the passing of the continuing resolution. We went through the budget process with Treasury and OMB. When we got to the OMB review, they had approved a fiscal year 1986 budget base of roughly around $290.3 million. Whereas, the amount of money that had been placed in the budget by Congress for that particular year, included the $3.6 million, thereby bringing the congressionally approved level to $294 million. Unfortunately, the continuing resolution had not been passed at that point in time. Therefore, the budget that we were working on with OMB and Treasury did not include it simply because they did not know whether it was going to pass. That was the reason, as I understand it, that it was left out. However, I would suggest that maybe you could ask Mr. Miller or somebody from OMB. I think they could probably give you a better answer than I.

THIRTY ADDITIONAL POSITIONS

Senator ABDNOR. OK, we will check it out.

Your fiscal year 1986 budget shows an increase of 30 permanent and FTE positions authorized by OMB without associated funds.

Do you feel that additional funding is required for these positions, and, if so, what increased cost will be necessary?

Mr. SIMPSON. We are talking about approximately $1.3 million. Yes; of course, we would like to have funding for it. I would suggest there is one method of obtaining funding, and we are pursuing it with Treasury and hope to go to OMB with a package in the not too distant future. That is, given the fact that we have been mandated through national security directive 207 the responsibility of protecting accompanying spouses of foreign heads of government, heads of state on public, private and official visits, we feel as though the State Department, obviously, has been budgeted for that particular responsibility. And, if we are now accepting it, which, in fact, we are, then it would seem to me that the money the State Department has received should come to us through the normal process of exchange simply because we are accepting their responsibility.

That would help us immensely and, of course, we will try to come up with funding in other ways to make up the difference for 30 positions.

Senator ABDNOR. Has anyone discussed this with OMB?

Mr. SIMPSON. We have not discussed it with OMB at this point in time. It has come up with the national security directive. It has just been given to us, and we are in the process of working with Treasury to pass it on to OMB.

ACCESS DEVICE FRAUD

Senator ABDNOR. Very good.

It appears that investigations in your new jurisdiction for access device fraud have increased significantly since its inception. Are your resources sufficient to handle such increased workloads?

Mr. SIMPSON. Right now, sir, we don't have the type of data base that can give us a good solid foundation as to what we are going to need in the way of resources. We hope to have a better handle on it next year as our data base grows. However, at the present time, we are able to handle all the cases by prioritizing. I think we are doing very well. For instance, in fiscal year 1985 we were able to seize over 40,000 counterfeit credit cards. And we also recovered 100,000 stolen, altered, or otherwise lost access devices.

Once the memorandum of understanding was signed with the Federal Bureau of Investigation as to responsibilities which we share with the Bureau, we made over 500 arrests in a matter of 6 months. We have also, by virtue of the industry's own estimation, not ours, in several cases in New York, saved them $500 million. That is not our guess, not our figure; that is the industry's figure. Mr. Houlihan has several exhibits you might find of interest, Mr. Chairman and the other members of the committee. They show some of the areas, particularly the credit card area, where people use either counterfeit and/or other types of credit cards to ultimately dupe the American public, unfortunately.

Kevin, would you show the chairman.

[Mr. Houlihan presents items to the chairman.]

OVERSEAS FIELD OFFICES

Senator ABDNOR. I just became brought up to date. I wish more people could witness that.

Now, funds were provided for overseas field offices, in light of recent terrorist activities.

Mr. SIMPSON. Right now, Mr. Chairman, because you and other members of the committee were supportive of trying to establish offices overseas, we were in a position to get authority from the State Department to establish an office in Milan. It is in the consular area of our facility in the Milan area, because of the counterfeiting activity in that particular area overseas. Unfortunately, because of a delay of 2 or 3 years, the funding that the committee had given us at that point in time may not be adequate. We have been required to use a larger number of people compared to what we originally thought we would have to because of the terrorism problem. And, with your permission, we would like to give you something for the record on that. It appears as though the funding is not going to be adequate at this point in time.

PROTECTION OF FORMER PRESIDENT MARCOS

Senator ABDNOR. We would like to have that if you are offering it for the record.

We have a number of questions for the record.

Am I correct in assuming that the Secret Service has undertaken the protection of Marcos? What is it going to do with your budget for fiscal year 1986?

Mr. SIMPSON. The answer to the question is yes, we have assumed the responsibility for Mr. Marcos' protection. Concerning the second question—could we get it for the record? We do not have a good handle on it yet.

[CLERK'S NOTE.—Information will be provided under separate cover.]

Senator ABDNOR. We are going to need all the help we can get.

Mr. SIMPSON. We will have it to the last penny.

COUNTERFEITING

Senator ABDNOR. In combating counterfeiting, could you briefly describe what is being done?

Mr. SIMPSON. We can. Mr. Houlihan is the expert and he can show you what we have.

[Mr. Houlihan discussing material at the rostrum with the chairman.]

Senator ABDNOR. Well, that concludes our hearing, Mr. Simpson.

Mr. SIMPSON. Thank you, Mr. Chairman.

Senator ABDNOR. It is always a pleasure to have you up here.

Mr. SIMPSON. I am sure, Mr. Chairman, you will be a good friend. I feel it is in good hands.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Thank you. There will be some additional questions submitted for your response.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Travel Expenditures

Senator Abdnor: With the passage of the Civilian Travel Expense Act of 1985, travel costs will no doubt escalate. Does the Service anticipate having to request additional funding in the near future?

Mr. Simpson: With the passage of the "Civilian Travel Expense Act of 1985" (P.L. 99-234) our travel expenditures are estimated to increase substantially. Because of the numerous foreign and domestic trips scheduled by our protectees, the Service has been required to make reprogramming and Supplemental requests over the years. For example, in fiscal year 1985 we requested and received Congressional approval to reprogram funds into our travel line item. More recently, the Secret Service incurred unexpectedly high costs associated with the United Nations General Assembly in New York City. In that the majority of the Service's travel expenditures are uncontrollable, we are currently estimating that additional costs on an annual basis will exceed $1.9 million, as a result of increases in per diem rate allowances pursuant to P.L. 99-234. In order to continue to conduct our protective travel activities at the same level, additional funding will be required.

National Security Directive 207 Protection of Spouses of Foreign Heads of State

Senator Abdnor: What affect will the national security directive regarding the protection of accompanying spouses of visiting heads of state have on the Service? Will additional positions be required?

Mr. Simpson: On May 1, 1986, Secret Service protection will be extended to accompanying spouses of visiting Heads of State. The precise impact this directive will have on the Service's resources cannot be determined until protection begins and travel patterns can be ascertained. Given the number of foreign dignitary spouses which have accompanied protectees and traveled the U.S. in the past, the Service estimates that annual funds of nearly $1.6 million and 15 additional permanent positions will be required to comply with Directive 207. The FY 1986 cost of this program is estimated to total approximately $825,000.

Increases Necessary to Maintain Current Levels

Senator Abdnor: After restoring the FY 1986 Gramm-Rudman-Hollings reduction, you are only requesting $4,845,000 for Maintaining Current Levels in FY 1987. Will you be able to maintain your current level of operation with this level of funding? Given current inflation levels of about 4% and your appropriation request of $307,140,000, it would seem your requirements would be more on the order of $12,000,000.

Mr. Simpson: The Service will be unable to maintain our current level of operation in FY 1987 on the basis of a $4,845,000 increase. If the Service does go forward with the program enhancements which are needed in FY 1987, which we intend to do, then the funding for the MCL's is inadequate. The Service estimates a requirement of $20,048,000 for increases necessary to maintain current levels. This amount would allow for normal inflationary increases, increases in rent and utility payments, increases in the cost of protective travel, and forecasted amounts required for within-grade increases and career ladder promotions.

The result of inadequate funding for unavoidable expenses such as these could have a serious impact on both our investigative and protective mandates. In order to maintain a current level of operation the Service will be forced to incur the total cost of $20,048,000. If the MCL total is authorized at $4,845,000, then the Service will have to absorb the balance of $15,203,000 from the investigative and protective programs. In effect this will erode our base level of enforcement and protective programs and could result in an adverse impact on the overall operation of the Service.

Relocation of Foreign Embassies

Senator Abdnor: Embassies appear to be tending to relocate in the suburbs. Will this cause problems for the Secret Service?

Mr. Simpson: The number of embassies located in the Maryland suburbs has remained at or about 30. The Uniformed Division has continued to cover this area with a cruiser patrol and officers by utilizing positions from cruiser zone areas in the District. The Secret Service has not been successful in acquiring these positions through past budget cycles. In FY 1988 the Service plans to again ask for additional cruiser and officer positions to cover the approximate 30 embassies. Failing to receive these resources requires the Uniformed Division to pull manpower from other required duties and areas of coverage.

At this time, the Secret Service provides no coverage for some suburban embassies, again, because of manpower/resource deficiencies.

Gramm-Rudman-Hollings Reduction

Senator Abdnor: Your request for FY 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen?

Mr. Simpson: In addressing the current and future impact that the Gramm-Rudman-Hollings sequestration has had on the Secret Service, it would be appropriate to first discuss major program areas which will be affected in order to realize the full FY 1986 reduction of $12,462,000.

FY 1986

The Secret Service's hiring practices for February 1 - September 30 of the fiscal year will be on a selective basis, for filling positions vacated through attrition. This will cause a reduction of approximately 65 full-time equivalent positions. In addition, a concerted effort is being made to cut back on overtime.

Permanent change of station (PCS) moves have been severely restricted. They are being limited to relocations necessary to staff critical vacancies.

The number of individuals being trained has been reduced in an effort to conserve tuition, education, and travel funds.

In order to effect savings in the supplies and materials category, the Service is being required to lower our normal operating supplies expenses. Purchase of ammunition used by law enforcement personnel in training and requalification exercises has been cut as well as the replacement of Uniformed Division uniforms and foul weather gear.

The Service was forced to cancel an entire order for the replacement of domestic use law enforcement vehicles and take reductions in the areas of voice privacy equipment and recurring equipment needs.

The characteristic, evidenced in the above list, is that the Secret Service is coping with sequestration in FY 1986 by postponing the acquisition of replacement manpower, equipment, and supplies as well as restricting career development activities. Severe cuts have been instituted in these areas in order to preserve resources devoted to our priority mission of preserving life and property.

Already, the effects of Gramm-Rudman-Hollings have further compounded the diminishment of the Service's programs in FY 1986 brought on by uncontrollable factors. For instance, we were granted limited program increases in fiscal year 1986. Additionally in October of FY 1986, we incurred $5.5 million in unbudgeted expenses associated with United Nations General Assembly 40, and were not granted a supplemental to cover these expenses.

Uncontrollable factors, such as inability to forecast the magnitude of our protective requirements years in advance, are further negatively compounded by the effects of Gramm-Rudman-Hollings. The Service therefore is compromised in its ability to confidently carry out its protective mission. This is critical at a time when terrorist aggression has attained new levels and is a genuine danger to those we protect.

The reductions imposed by the Gramm-Rudman-Hollings Act will negatively affect our resources and manpower currently used to effectively fulfill our bureau mission. However, since our mission to protect life and property is mandated, all in our power will be exercised this year to see that the mission is carried out.

FY 1987

If an adjustment for Gramm-Rudman-Hollings was applied to our FY 1987 request on the order of $12,642,000 the Service would be hard pressed to fulfill our mandated responsibilities. Doing so depends on an annual budget flexible enough to fund the spontaneous and unpredictable travel costs associated with our protectees.

We would be forced to continue postponing a number of basic acquisitions. For example, such an adjustment would further lower the Service's equipment base which is already deficient.

Further reductions due to Gramm-Rudman-Hollings will worsen the Service's ability to maintain a dependable vehicle fleet and functioning equipment base. The Service could not fill a significant number of vacant positions and would have to consider RIF's; could not provide adequate employee training; could not make necessary managerial and other employee changes of station utilized to build a flexible and experienced special agent workforce.

In sum, as a first step, we would have to continue postponing a number of activities which are vital to replenishing our manpower and capital resource base. Over the long term, this is impractical and unproductive. Moreover, the Secret Service - if forced to operate at the FY 1986 level - would be precluded from implementing critical upgrades to our protective programs that are embodied in the $16,537,000 of program increases in the budget before you. Funding would not be available for implementing technical security programs at the White House, acquiring communications and ADP equipment to support the 1988 Presidential Campaign protective activities, and acquiring armored limousines. The importance of these areas to the security of government facilities, officials, and conduction of a safe political process is self evident.

Senator Abdnor: Would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

Mr. Simpson: Yes, it would be too much to assume that the Secret Service could live with that level as a base in FY 1987. As we previously mentioned, the Service has deferred major purchases in FY 1986 in order to comply with the Gramm-Rudman-Hollings reduction. These deferrals alone will result in the Service operating on a catch-up basis in FY 1987. To further deplete funds could have a detrimental impact on our protective and investigative operation by depleting the "readiness" of our manpower and resource base.

We are aware of certain proposals such as S. Res. 360 expressing the sense of the Senate that current funding levels for Federal law enforcement and related agencies that provide domestic internal security protection from terrorists be maintained through fiscal year 1991. Considering the massive cost and upheaval associated with successful assassination attempts and terrorist acts, I feel it is of critical importance that law enforcement functions not be eroded by indiscriminate funding reductions.

Space Requirements

Senator Abdnor: Have you reached the 135 square foot goal? If not, why and what is your target date?

Mr. Simpson: In response to General Services Administration Temporary Regulation D-71, the Secret Service has recently developed and submitted information regarding our Supplemental Space Factor to the General Services Administration. The Supplemental Space factor represents a percentage of space defined as office space which, in actuality is not utilized for typical office work (i.e., interview rooms, prisoner processing rooms, polygraph rooms, etc.). Since this space has a more specialized non-office function it will not be included in the calculation of our utilization rate. By excluding the Service's Supplemental Space, our nationwide utilization rate is 134 square feet per person.

Overseas Offices

Senator Abdnor: Funds were previously provided to the Secret Service to obtain overseas field offices. Considering recent terrorist activity overseas, are these funding levels sufficient to properly provide physical security for your foreign installations?

Mr. Simpson: No, Sir. The Secret Service budgeted in 1983 for new foreign field offices beginning with the FY 1985 budget. The situation overseas has changed dramatically over the past three years. An office was established in Milan, Italy (FY 1986) and in light of terrorist activities around Italy (the hijacking of the Achille Lauro and the Rome Airport bombing) our original budgeted funds of $240,000 for the establishment of three offices is not now adequate for the provision of physical security. The added costs result from the procurement of office space in a safe location, hardening that space, and armoring official vehicles to provide a safer working environment for office employees. In addition, two other factors have affected the inadequacy of the $240,000 budgeted for overseas offices. Both foreign and domestic prices have inflated substantially since 1983, and we are required to pay for increased staffing as a result of State Department regulations. We anticipate that approximately $600,000 in additional funds will be required for the Milan Field Office alone, not to mention two other foreign offices we hope to establish in the near future.

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

STATEMENT OF STEPHEN E. HIGGINS, DIRECTOR

ACCOMPANIED BY:

JILL E. KENT, DEPUTY ASSISTANT SECRETARY FOR DEPARTMENTAL FINANCE AND PLANNING, DEPARTMENT OF THE TREASURY
DAVID D. QUEEN, DEPUTY ASSISTANT SECRETARY (ENFORCEMENT), DEPARTMENT OF THE TREASURY
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CHESTER C. BRYANT, COMPTROLLER
PAUL R. GENTILLE, FINANCIAL MANAGER

PREPARED STATEMENTS

Senator ABDNOR. Today, our next witness is Mr. Higgins with the Bureau of Alcohol, Tobacco and Firearms [ATF].

Gentlemen, we welcome you to the committee. You found us here talking to ourselves. We are trying to figure out what happened to everyones' budget with that new proposal they came up with last night. You may already know, I do not know.

We welcome you to the committee and you may proceed in any manner you care.

Mr. HIGGINS. With your permission, Mr. Chairman, I would like to submit for the record a detailed general statement and offer some brief introductory remarks.

Senator ABDNOR. Fine. Without objection your original testimony will be part of the record.

[The statements follow:]

STATEMENT OF STEPHEN E. HIGGINS

It is a privilege to appear before you in support of the FY 1987 budget request for the Bureau of Alcohol, Tobacco and Firearms. Accompanying me are my colleagues Mr. William Drake, Associate Director, Compliance Operations; Mr. Phillip McGuire, Associate Director, Law Enforcement; Mr. Chester Bryant, Comptroller; and Mr. Paul Gentille, Financial Manager.

Our FY 1987 budget request is $178,463,000 and 2,850 staffyears, which represents a net increase of $11,742,000 and a decrease of 91 staffyears compared to the proposed authorized level for FY 1986. This request includes program reductions of $4,650,000 and 91 staffyears, offset by maintain current level increases of $8,901,000, and $7,491,000 for the restoration of the FY 1986 Gramm-Rudman-Hollings (G-R-H) reductions.

Due to the G-R-H legislation, the proposed authorized level for FY 1986 includes a reduction of 4.3 percent or $7,491,000, from the Continuing Resolution appropriation of $174,212,000 and 2,941 staffyears. While the G-R-H reductions will have a detrimental impact on all Bureau programs during FY 1986, we have attempted to minimize this impact by maintaining an adequate staffing level, focusing the reductions in operational areas rather than personnel. A detailed discussion of the impact of the G-R-H cuts is contained in the FY 1987 budget justification. The total proposed authorized level for FY 1986 is $166,721,000 and 2,941 staffyears.

I would like to take this opportunity to report to you on several management initiatives.

MANAGEMENT EFFICIENCIES

Administrative

The Bureau's efforts to realize further efficiencies in administrative processes continued at a vigorous pace during FY 1985. Our most noteworthy achievement in this area has been the centralization of all administrative support. This action was recommended by an ATF interfunctional task force in November 1984, and was proposed to the Department in January 1985. Our five regional administrative offices were officially closed on October 1, 1985.

While administrative centralization eliminated management and supervisory positions in the regions, some of the nonsupervisory staffyears

were reassigned to Headquarters to accommodate the centralized workload. The remainder were used to provide an administrative assistant for each principal field office, comparable to the Secret Service and other administratively centralized agencies. Thus far, we have experienced no significant problems attributable to centralization. The administrative assistants are providing effective day-to-day liaison between Headquarters and the field, and our field managers now enjoy direct access to individual program specialists at Headquarters. I am also happy to report that these changes took place without adversely affecting any of our displaced regional administrative employees. Advance notification allowed most individuals to locate other positions, either within or outside the agency, before the October 1 implementation date.

Concurrently with this major organizational change, the Bureau has continued to rely on services from the private sector and other governmental agencies to minimize in-house staffing needs. In May 1985, our forms and publications distribution operations were assumed by an organization for the handicapped under the auspices of the Wagner-Jarvis-O'Day Act. Throughout the entire year, we have used private sources as well as the Treasury and Justice Departments to assist us in meeting day-to-day data processing requirements. In addition, major hardware and software contracts were recently awarded to outside firms in conjunction with ATF's Systems Modernization Plan; without this support, our internal data processing staff would have to be doubled.

We are continuing to explore further opportunities for productivity increases utilized under the A-76 program. Comprehensive reviews of our laboratory, ADP and communications activities were initiated in FY 1985, and will be completed by the end of FY 1986. These review areas, as a whole, account for approximately 82 staffyears. It is not anticipated that any further staffyear reductions will result from these studies, since most functions under review are closely tied to our law enforcement and tax collection activities. In addition, we believe that the Bureau's expertise in many areas of forensic analysis can not be easily duplicated by commercial sources. However, we do anticipate the potential privatization of some services, such as ADP "batch processing" tasks.

Finally, a third major emphasis in our management improvement efforts has been in the implementation of the Federal Managers' Financial Integrity Act (FMFIA) of 1982, under the guidance of OMB Circular A-123. Through the process of regularly scheduled vulnerability assessments and supplementary internal control reviews, we have identified and corrected a number of internal control deficiencies. We continue to refine our FMFIA evaluation mechanism as we gain more experience with the intent of the Act, and have also included a session on the FMFIA as a permanent part of our in-house training course for first-line supervisors.

Compliance Operations

Compliance Operations is making management improvements by automating high-volume operations, consolidating functions that can be run more efficiently at one location, identifying and acting on changes in industry and population trends, and providing equipment and training to its employees so that they can work more effectively.

Each year the number of licensees and permittees regulated by ATF increases. For example, in 1980 the number of firearms licensees was 179,000; by 1985, that population had grown to 249,000, and we expect that number to increase to 280,000 by the end of 1986. To handle the increasing number of firearms licensees with reduced staffing levels, we are evaluating the feasibility of consolidating our seven regional firearms and explosives functions into one highly automated location. We believe that consolidation will enable us to more effectively respond to inquiries from law enforcement officials, and act upon license applications more efficiently.

Another improvement is the "lockbox" for firearms and explosives application fees which ATF implemented this past summer. No problems have been encountered since it has been in place. Not only are we saving over $100,000 a year in processing costs, but we are also able to issue firearms and explosives licenses more expeditiously.

ATF and the U.S. Customs Service have entered into an agreement by which ATF auditors and inspectors will perform audits at customs bonded warehouses which are co-located with facilities regulated by ATF. The overall efficiency of the Department will be improved and the agreement will also benefit industry because its representatives and operations will be disrupted less frequently. In a somewhat related matter, we are exploring with IRS the possibility of ATF personnel performing excise tax audits of firearms manufacturers, who are licensed and inspected by ATF. This too could result in a greater efficiency both to the Treasury Department and to the taxpayers.

ATF processes thousands of requests each year for alcoholic beverage label approvals. By statute, we also maintain detailed records concerning fully automatic and certain other weapons covered under the National Firearms Act. In these two areas, we have automated our files so that the records are more efficiently maintained and information more accessible. The automation of our label approval files has been particularly advantageous to industry because we are able to act on their label approval requests at least twice as quickly as in the past and because industry representatives and members of the public now have speedy and accurate access to our label approval files.

ATF has upgraded the skills of its employees by providing them with modern equipment and advanced training. We have completed the process of obtaining office computers for all regional and area offices, and this year, we have started to obtain portable computers which field employees can utilize at on-site examinations. The Bureau continues to provide advanced training in several areas for its employees, for example, automated data processing (ADP), Cost Accounting, interview techniques, and management courses.

LEGISLATIVE CHANGES

Two years ago, Congress enacted the Deficit Reduction Act of 1984. One of the provisions of that law was an increase in the excise tax rate for distilled spirits from $10.50 to $12.50 per proof gallon, effective October 1, 1985. Along with that increase, a one-time floor stocks tax of $2.00 per proof gallon was levied on all distilled spirits in inventory at every commercial outlet on that date.

To ensure that all distilled spirits floor stocks taxes are paid, the Bureau conducted an extensive information campaign combined with a highly visible, concentrated examination program. All members of the distilled spirits industry from producer to retail outlet were informed of the excise tax increase and related floor stocks tax. ATF representatives attended numerous industry meetings to inform the industry about the tax increase and floor stocks tax process.

In addition to these efforts, ATF inspectors conducted over 5,000 inventory verifications in October and November 1985 to ensure that industry members would pay the proper amount of floor stocks taxes the following April. These inventory verifications have resulted in the collection of approximately $917,000 in additional taxes. In-depth examinations will be conducted after April 1986, once the tax returns are filed, and after we have identified those taxpayers where noncompliance would cause the greatest revenue loss.

In another development, both houses of Congress are considering legislation which would establish excise taxes on snuff and chewing tobacco. Although the final version of these bills is not known, we are making preparations to implement the necessary changes in regulations and internal procedures should this legislation be enacted into law.

LAW ENFORCEMENT

The Bureau has realized important achievements in the fight against violent crime as a result of the emphasis of our law enforcement programs. Our firearms, explosives, and arson programs in particular have been successful in combatting crime, especially in the areas of bombings, narcotics trafficking, arson-for-profit, terrorism, and other crimes of violence.

In FY 1985, the firearms program focused on apprehending previously convicted felons who, having gained their freedom, continue to perpetrate their particular brand of violence by illegally using firearms. This classification of criminal is singularly responsible for more violent crimes than any other group; their menacing presence affects the way our citizens live and our businesses operate. We will continue to identify them, vigorously investigate their crimes, and perfect criminal cases for prosecution whenever possible.

We are aware of the recent alarming increase in the number of both domestic and international terrorist/hate groups in our nation. As a result, ATF special agents conducted investigations concerning the violent misuse of firearms and explosives by criminals whose terrorist and violently discriminating activities occurred in this country. Identification and exposure of these people and their associates has continued to heighten our nation's awareness of their violent acts.

Additionally, unscrupulous property owners who hire arsonists to burn their buildings for insurance monies, and never consider the lives of firefighters, police officers, or medical personnel who die or are injured while performing their duties, have been targeted for intense investigation. These criminals' wanton disregard for those responsible for protecting the property and lives of our citizens is so repugnant that enhanced penalties have been incorporated into Federal arson statutes and are applicable in those instances where death or injury occurs as a result of these fires. ATF's enforcement effort under these statutes will be paramount.

Furthermore, ATF is committed to exposing those corrupt profiteers who knowingly and willfully traffic in firearms, ammunition, and explosives in furtherance of all types of criminal activities.

Explosives Program

The vicious and indiscriminate nature of criminal bombings evokes outrage and fear in the citizens of this nation. The visible public reaction to the abortion clinic bombings during 1985 is graphic testimony.

Explosives investigations continue to be our number one priority. During FY 1985 there were 1,063 reported bombings or attempted bombings which resulted in 30 deaths, 154 injuries, and in excess of $9.7 million in property damage. Additionally, over 15 tons of explosives were illegally diverted in 212 reported thefts. This figure is significant since most stolen explosives are never recovered. Due to the availability of stolen explosives in the underground marketplace and ready access to bomb-making technology afforded by numerous publications in circulation, the potential for the criminal misuse of explosives must be assessed as very high.

ATF's posture in addressing its explosives enforcement mission is multifaceted and dynamic in nature. This can be best illustrated by a brief discussion of our explosives program, which is designed to reduce the number of criminal bombings through active prosecution, assisting State and local agencies in their efforts to interdict the illegal use of explosives, and removing the hazards to the public posed by improper storage or use of explosives.

Traditional Enforcement Activities

In FY 1985 ATF recommended a total of 381 defendants for prosecution for violations of Federal explosives laws. The following summarized explosive cases, limited in number as necessitated by the nature of this presentation, are only examples of the significant results achieved by ATF in the traditional explosives enforcement area.

> Between January 1984 and January 1985, eight abortion facilities, the headquarters for the National Abortion Federation and an American Civil Liberties Union Office located in the area encompassed by Washington, D.C. and the States of Delaware, Virginia, and Maryland suffered bombing and arson damage estimated in excess of $840,000. On January 19, 1985, following an intense ATF investigation conducted in cooperation with affected State and local agencies, three men were arrested for perpetration of all those criminal acts. Subsequently, two defendants pled guilty and received sentences of 15 years and 2 years imprisonment respectively. The third man was tried, found guilty, and sentenced to 10 years. In addition, restitution totalling $97,000 was ordered of two of the defendants.
>
> During the early morning hours of Christmas Day, 1984, bombs went off at three separate abortion facilities all located within two miles of each other in Pensacola, Florida. These bombings caused a combined loss estimated in excess of $425,000. An ATF National Response Team was activated and conducted the searches of the bomb scenes and initial investigation. Six days later ATF initiated arrests of two men and two women for these bombings as well as the bombing of another Pensacola abortion facility which had occurred in June 1984. Subsequently, the two men were convicted of the three Christmas day bombings, sentenced to serve 6 concurrent 10-year terms in prison with 5 years of supervised probation upon release, and ordered to make combined restitution in the amount of $353,000. The women were found guilty of aiding and abetting the bombings and were sentenced to serve 5 years probation each.
>
> In May and June 1984, a series of 24 related bombing incidents were perpetrated in the States of Wisconsin, Illinois, and Minnesota. Explosive devices baited with dollar bills and notes were placed in parks and recreational areas to lure victims. The bombs, claimed as having been set by the North Central Gay Strike Force Against Public and Police Oppression, caused injuries to five individuals. An eight-State task force, incorporating all affected State and local agencies, was organized and coordinated by ATF during this investigation. On June 8, 1984, an individual was injured when a bomb exploded in his vehicle in Mason City, Iowa. ATF agents, who were in the area having just distributed information regarding the serial bombings, responded to the bomb scene search and actively participated in the investigation. Information developed pointed to the injured person as being involved in the 24 bombings. Subsequently, this individual admitted that he alone constituted the North Central Gay Strike Force Against Public and Police Oppression and was solely responsible for all the bombings. Following a series of lengthy psychiatric examinations, this individual is presently awaiting trial.
>
> On July 9, 1985, in Naples, Florida, two members of a wealthy family were killed and a third seriously injured when two bombs exploded inside the vehicle they were driving. ATF immediately responded to the scene. All evidence collected at the scene and subsequently obtained

was submitted to ATF laboratory facilities for analysis. Investigation by ATF in conjunction with the Collier County Sheriff's Office revealed that a brother/son to the deceased and injured individuals had purchased items similar to those used in the construction of the bombs utilized. This individual was in line to inherit $15 million upon the death of the three victims of the car bombing. ATF developed and analyzed evidence leading to the arrest on August 22, 1985, of this individual on State charges of murder and attempted murder. Adjudication of this case is still pending.

ATF's timely, effective, and professional reaction to explosives investigations is the result of in-depth training of its agents and innovative programs established to support and enhance the field agents' capabilities. Among these programs are:

The Explosives Incident System (EXIS): EXIS is the recipient of all pertinent information from every ATF bombing investigation and is capable of researching bombings as to trends, patterns, targets, componentry, and modus operandi. All information available through EXIS is routinely forwarded to the U.S. Secret Service, Federal Bureau of Investigations' Domestic Security and Terrorism Section and U.S. Military investigative agencies.

National Response Teams (NRT): Four NRT's are strategically located throughout the country and are capable of mobilizing a team of specialized investigators to the site of a major explosives/arson incident within 24 hours to conduct searches and follow-up investigations.

Advanced training of ATF Special Agents: Yearly, a number of ATF special agents are selected and undergo training in post-blast investigation, explosives handling and destruction, or training as explosives instructors.

State/Local Training

As part of ATF's commitment to assistance to State and local law enforcement, the Advanced Explosives Investigative Techniques (AEITC) course of instruction presented at Glynco, Georgia, was initiated in 1982. To date, 424 State and local officers have attended this program. Originally developed in conjunction with the International Association of Bomb Technicians and Investigators (IABTI), the course is considered "state-of-the-art" in post-blast investigation and elicits an enviable reputation among all those who have attended.

Public Safety

ATF approaches the threat posed by illegal and/or unsafe use of explosives on two fronts: interdiction/disruption of illegal and/or unsafe practices and education of the public in recognition of and self-protection against hazards.

During FY 1985, ATF was actively involved in the investigation of illegal fireworks manufacturers, transporters, and distributors (M-80 Project). Explosives used in M-80 and M-100 type devices are highly sensitive. When considered with the quantities of powder used in the manufacturing process and the usual lack of quality control and safety precautions, the potential for disaster is enormous. Presently, plans are underway to analyze all data available, by ATF district, to more effectively interdict illegal fireworks manufacturers, distributors, and the illegal sources of raw materials used in the manufacture of these devices.

During FY 1985, efforts continued through the Office of Congressional and Media Affairs, local law enforcement authorities, and the media to increase public awareness of the threat posed by illegal fireworks and to develop an appreciation of their danger potential. In addition, the 1985 abortion clinic bombings along with other criminal bombings, both domestic and international, have heightened the public awareness of bomb threats. In recognition of the need of the general public for practical information on how to defend against and react to bombings and bomb threats, ATF has entered into a program to update and offer training to the private sector. Plans initiated in 1985 are currently being implemented through awareness training presentations and the preparation of publications on the topic.

1985 Initiatives

During FY 1985, to address the increased threat posed by terrorism, ATF undertook two new initiatives.

I-EXIS: During 1985, ATF studied the feasibility and took the initial steps in implementation of an international explosives incident data base. ATF currently has the EXIS program, discussed previously, where information from all reported domestic explosives incidents are entered into a data base. However, the U.S. Government has no program which would permit timely comparison of international incidents or international incidents with domestic incidents. I-EXIS will be a separate program that will contain information on foreign explosives incidents and have the capability to compare those incidents not only between each other but also with domestic incidents.

International Training: ATF is a contributing member to the Government-wide Anti-Terrorism Assistance Program (ATAP). This program, administered by the Office of Counter-Terrorism and Emergency Planning, Department of State, was created in response to the alarming increase in international terrorist activity. The objective of the program is to develop specialized expertise in foreign law enforcement officials through training and related assistance. In FY 1985, ATF trained 60 law enforcement personnel, representing the participating foreign governments of Costa Rica, Colombia, Egypt, and Honduras in four separate schools. In 1986, two other schools instructing 32 additional foreign law enforcement officials have been scheduled.

Arson Enforcement

While arson is basically a State and local enforcement responsibility, the national magnitude of the problem has exceeded the capabilities of any one agency to effectively respond to the full range of arson crimes occurring within its jurisdictional area. ATF, in promoting the Federal role in this critical program, has spearheaded the drive to coordinate enforcement efforts among Federal, State and local sectors. However, the overall effort by ATF is selective in that we actively investigate only a very small percentage of the total arsons committed throughout the country. We are confident that the direction of our investigative activity, along with our assistance to State and local authorities, is compatible with the overall Federal role required to combat the crime of arson.

During FY 1985, ATF recommended 180 cases and 410 defendants for prosecution, which represents a 35 percent increase in cases and defendants from the previous fiscal year. ATF resources are directed toward complex arson-for-profit cases involving industrial or commercial property. Our arson enforcement efforts are also focused on organized crime, arson-for-profit rings, white collar and violent criminals.

In addition to the apprehension and prosecution of violators, ATF utilizes a procedure to capture the "insurance dollars saved" through ATF's arson investigative efforts. During FY 1985, $77.3 million was "saved" in the sense that in the absence of effective law enforcement efforts, the insurance industry could potentially have been required to pay out $77.3 million more in arson-related claims, thus creating a greater burden upon the premium-paying general public and the Nation's economy as a whole. It should also be noted that many of these respective dollar amounts will increase as the ongoing cases are completed. These savings constituted an 80 percent increase over the previous year's figures.

In FY 1985, ATF continued its assistance to State and local authorities through the services of four National Response Teams, located in the Midwest, Northeast, Southeast, and Western regions of the United States. These teams, in their short 6-year history, have been activated in response to 130 incidents, involving 94 deaths, 381 injuries and property damage in excess of

$406 million. These teams have a phenomenal 98 percent rate of determination as to the cause of the incident.

The arson task force concept continues to be one of our most successful strategies in combatting this most difficult crime. In 14 cities, Seattle, San Francisco, Los Angeles, Houston, Chicago, Boston, New York, Philadelphia, Atlanta, Detroit, Newark, Dallas, St. Paul and St. Louis, the concept is fully operational utilizing the talent and resources of Federal, State and local agencies. Additionally, the first of two new task force groups will be initiated in FY 1986. Another city will be selected and added by the end of the fiscal year, bringing the total arson task forces to 16.

In October 1982, ATF initiated a 2-week State and local training course in advanced arson-for-profit investigations. This training, unavailable anywhere else, deals with in-depth investigation into arson-for-profit cases beyond the cause and origin determination. To date, over 400 State and local police and fire service personnel have attended this highly acclaimed course. This training is in such demand that it has become a permanent part of ATF's arson enforcement program.

In response to repeated requests from State and local arson investigators, ATF initiated a series of seminars directed toward educating prosecutors at both the State and Federal levels in the crime of arson. These seminars acquaint the prosecutors with cause and origin determination of a fire and legal considerations, as well as successful prosecution and courtroom techniques. The following cases are examples of significant results achieved in the Bureau's arson enforcement area:

> ALBUQUERQUE, NM: In April 1983, the Western NRT responded to a million-dollar arson which destroyed Ned's El Portal Restaurant and Lounge. ATF identified the arsonist, who implicated the restaurant owners (a prominent local family) in the arson-for-profit scheme. During the course of the investigation, ATF developed information that one of the family members was involved in an Albuquerque cocaine organization. DEA and ATF conducted a joint investigation into the subject's criminal activities. In April 1985, four family members were indicted on Federal arson charges, stemming from the burning of their restaurant and the collection of over $500,000 in false insurance claims. On June 10, 1985, two family members and a third individual entered pleas of guilty to Federal narcotics charges. Two of them were later sentenced to serve respective sentences of 10 and 12 years. The third was given 3 years probation. As part of a plea agreement, the U.S. Attorney dismissed the arson charges against family members in exchange for their pleas to the drug charges and confessions in open court to the arson.

CHICAGO, IL: On April 18, 1985, a former firefighter appeared in U.S. District Court and pled guilty to one count of conspiracy and one count of possession of a destructive device. Per a plea agreement with the U.S. Attorney's Office, the defendant will serve as a Government witness during the trial of his co-conspirator, also a former fireman. The conviction was the result of a joint investigation by ATF and the Chicago Police Bomb and Arson Squad of a conspiracy to burn vacant properties for profit. The subjects resigned from the Chicago Fire Department following their arrest in January 1985.

MONTGOMERY, AL: On February 20, 1985, three individuals entered guilty pleas in Federal and State court to civil rights and arson violations. The principal defendant, a KKK organizer, was sentenced to 27 years' imprisonment; the two remaining defendants (also KKK associates) each received 7 1/2-year terms. On the same day, two additional KKK associates pled guilty in State court to burglary and theft of explosives. Both defendants received terms of 2 to 2 1/2 years. The sentencing of the five defendants culminated a 19-month investigation by a task force comprised of ATF, other Federal agencies, and State and local authorities. The investigation was initiated following the July 1983 arson of the Southern Poverty Law Center, a KKK watch organization.

MADISON, WI: On October 23, 1985, in State court the national president of the Ghost Riders Motorcycle Gang and two gang members were found guilty of murder and arson charges. All three subjects have been sentenced to life imprisonment. The defendants were convicted for their roles in the March 1983 arson of a gang-operated tavern and the murder of a female associate who they suspected of being an informant. At the direction of the president, two gang members drugged the woman and left her in the tavern to die in the ensuing fire. The convictions were the result of an investigation conducted by the ATF/Presidential Narcotics Task Force. The defendants are 3 of 38 gang members and associates recommended for prosecution by the task force.

LAWRENCE COUNTY, IN: On August 16, 1985, two ATF defendants were sentenced in the Superior Court of Lawrence County. One defendant received a total of 40 years' incarceration and was ordered to pay $21,500 in restitution. The second defendant was sentenced to 6 years' imprisonment, 5 years suspended. One of the defendants, a three-time convicted felon, was considered a major criminal in the South Central Indiana area. The convictions were the result of an ATF investigation into a series of arson-for-profit fires of commercial and residential properties. The Lawrence County Prosecutor praised ATF for its professionalism and expertise while conducting the first successful arson prosecution in the judicial district.

PORTLAND, OREGON: On October 4, 1985, a defendant was found guilty by jury trial in Oregon State Court of the July 1983 arson/bombing of the Rajneesh Hotel. The subject could receive up to 20 years' imprisonment. The conviction concluded an intensive, 14-month investigation involving ATF's Seattle, Portland, and Denver offices, as well as the Seattle, Englewood, Colorado, and Portland Police Departments. The defendant was identified as an active member of a radical East Indian Moslem splinter group known as Fugra whose membership has been linked to religious assassinations, bombings, arsons, and violent anti-Hindu activities in the United States. As a result of the arrest and ATF's extensive background information regarding the Fugra group, two State search warrants were executed on the Fugra commune in Englewood, Colorado, where the subject lived with four other alleged Fugra members. The search warrants resulted in the collection of evidence and documents which proved critical to the State's prosecution. ATF has perfected a criminal case against the defendant's wife for conspiracy to aid and abet the defendant's unlawful flight to avoid prosecution. The case has been accepted by the U.S. Attorney.

Firearms Enforcement Program

ATF's firearms enforcement program focuses on those crimes, criminals, or criminal organizations which pose the greatest threat to American society based on a consensus opinion of the criminal justice community. Accordingly, our firearms program is prioritized and continually revamped to ensure that we are addressing the most serious firearms threats.

Our firearms program can be categorized into five major areas. The first is classified as the Dangerous and Special Offenders/Organizations, focusing on those individuals or groups identified as habitually active and violent criminals. Greater emphasis has been placed on organized crime figures, members of violent extremist groups, outlaw motorcycle gang members, and major narcotics dealers. The following are but a few of our accomplishments in the area:

> On December 5, 1985, a major organized crime figure was convicted in Chicago of Federal drug charges, relating to his possession and sale of cocaine to an undercover ATF special agent. The defendant had previously been identified by a U.S. Senate subcommittee as a high-ranking soldier in a Chicago La Cosa Nostra family. The Drug Enforcement Administration (DEA) had also identified him as a Class I trafficker. At the time of his conviction he was on Federal parole for dealing in cocaine and had served 12 years in prison as the result of armed robbery and narcotics convictions. ATF began this investigation because of the organized crime figure's alleged firearms violations. As a result of that investigation, he is also facing an additional Federal conspiracy trial with 5 other defendants on Federal explosives and firearms charges. Those charges resulted from his alleged participation in the planning of an armed robbery that included the delivery of guns and bombs to the ATF agent.
>
> On August 12, 1985, in Little Rock, Arkansas, the leader of the Covenant, the Sword, the Arm of the Lord (CSA), a white supremacist organization, pled guilty to a Federal firearms conspiracy violation. Five CSA members also pled guilty to the same charge. In addition, the CSA head pled guilty to the possession of an unregistered machine gun. These convictions resulted from a 3-year investigation by ATF of alleged firearms and explosives violations by the CSA. This inquiry culminated in the execution of Federal arrest and search warrants at the CSA compound in Marion County, Arkansas, in April 1985. This raid resulted in several arrests and the seizure of a large quantity of firearms that included 30 machine guns, 9 silencers, 35 destructive devices, and 3 mines.
>
> On January 24, 1985, two members and the leader of a regional Posse Comitatus group were convicted in St. Paul of Federal firearms violations, assault on a Federal officer and conspiracy to assault Federal officers. This joint investigation stemmed from alleged threats by this Posse Comitatus group to bomb three Federal buildings and kill Federal officers. In October 1984, ATF agents executed 4 Federal search warrants and seized 50 firearms, including 6 unregistered machine guns, 4 unregistered hand grenades, 150 pounds of smokeless powder, and a large quantity of blasting caps, high explosives and ammunition. All three members opposed the Federal income tax laws and advocated the murder of any Federal officer who enforced these laws. The defendants rejected all Federal firearms laws and encouraged the unregistered

possession of machine guns and bombs. One defense witness stated emphatically that a citizen should arm himself with any and all weapons short of nuclear bombs.

Since the enactment of the Comprehensive Crime Control (CCC) Act, results of significant sentencing of these habitual and violent criminals have started to generate increased interest among prosecutors and law enforcement in general. The enhanced penalties for armed career criminals convicted under this legislation have given law enforcement a much needed tool to rid society of persistent, habitual, and violent offenders. Notable examples of sentences imposed under this statute follow:

> On November 1, 1985, a DEA class I violator and large-scale narcotics distributor from St. Louis, Missouri, received a combined sentence of 22 years without parole, 5 years special parole, and $20,000 in fines. The sentence resulted from his conviction for distribution of narcotics and receipt of firearms.
>
> On June 13, 1985, in St. Louis, a narcotics violator and convicted felon who was found to be in possession of a firearm and P.C.P., was tried and sentenced under the CCC Act. The subject received two consecutive, 15-year sentences.
>
> On January 1, 1986, in Dallas, Texas, a Federal judge sentenced a multiconvicted felon having an extensive history of armed robbery and burglary to 25 years without parole for possession of a firearm and other related charges.

The use of this statute is increasing rapidly as other law enforcement agencies become aware of the severe penalties which can be imposed on convicted felons possessing firearms.

The second major category of the firearms program concerns criminal trafficking of all types of firearms. This area can be summarized as the identification, investigation, and apprehension of individuals or groups who are substantial sources of firearms for the criminal element, and who demonstrate a flagrant disregard of the law. Included are those who illegally deal in stolen firearms and are involved with burglary and fencing operations and those who illegally traffic, manufacture, or convert machine guns and silencers.

During FY 1985, ATF seized 2,042 machine guns, of which 1,609 (79 percent) were conversions. We consider the illicit conversion of legitimate firearms to machine guns as a major law enforcement problem. The following are some of our accomplishments in this area:

> In June 1985, two corporations and their principal officers were indicted for firearms conspiracy charges in Atlanta, Georgia. The defendants are alleged to have conspired to illegally manufacture and sell component

parts of machine guns, silencers, and other controlled firearms that could be assembled into illegal firearms. During this investigation, ATF seized business documents from the defendants. After analyzing the records, ATF developed investigative leads that resulted in the execution of 112 Federal search warrants nationwide and the recommendation of 102 defendants for prosecution. As a result of all the investigations, ATF seized 382 machine guns and 335 silencers.

On March 8, 1985, Chicago ATF agents executed a Federal search warrant at an individually owned tool and die machine shop in Elk Grove Village, Illinois. The ATF agents seized 18 unregistered machine guns, 7 unregistered silencers, and 44 illegally manufactured conventional firearms.

On September 13, 1985, a Federal firearms licensee (FFL) was sentenced in a West Palm Beach, Florida, Federal court for the illegal possession of machine guns and silencers. The firearms dealer, who is also an air traffic controller, still faces State charges of cocaine possession and distribution. The State and Federal charges arose from a May 13, 1985, Federal search warrant executed by ATF agents and the Broward County Sheriff's Office at the dealer's Fort Lauderdale residence. During the search, law enforcement officials discovered and seized 2 unregistered silencers, 2 unregistered machine guns, 1 weapon made from a rifle, numerous machine gun and silencer parts, and 1.2 pounds of cocaine.

During FY 1985 we also identified and apprehended three major sources of weapons sold to members of "The Order," a militant white supremacist group. The first source was a licensee, who was arrested. A search of his residence turned up illegal conversion kits for machine guns. The second source, another licensee, sold $12,000 worth of firearms, ammunition, silencer parts and machine gun parts to the Order member who subsequently was arrested for the April 1985 murder of a Missouri State Highway Officer. The third source provided illegal conversion parts for machine guns not only to members of The Order, but also to major narcotics dealers in the Pacific Northwest.

The third major firearms program area involves the illegal movement of firearms in international traffic, a worldwide concern. Since ATF has the primary responsibility in this country for the enforcement of Federal firearms laws, the Bureau must maintain an aggressive commitment toward neutralizing the illicit movement of firearms into, and out of, the United States. Examples of our efforts in these areas are:

An investigation established that between August 1, 1979, and March 7, 1980, a New York State resident illegally purchased 87 handguns from an FFL in Miami. The purchaser has a long history of affiliations with various domestic and international terrorist and radical organizations. The guns were apparently smuggled out of the United States in diplomatic pouches with the assistance of a diplomat attached to the South Yemen Mission in New York City. This official was expelled from the United States for his alleged involvement in this firearms trafficking. The defendant was convicted of Federal firearms charges in Miami on July 22, 1985.

On October 17, 1985, a Federal grand jury in Fort Lauderdale indicted three people for conspiracy and Federal firearms violations. In the indictment, this trio is accused of recruiting 12 other unnamed, unindicted people to buy guns. Each individual was paid $40 for each firearm purchase. It is believed that between July 1980 and April 1983, the three coconspirators may have illegally smuggled over 300 weapons to Colombia. The majority of these firearms are believed to have been

> .30 caliber paramilitary rifles that went to M-19, a leftist political revolutionary organization.

The fourth firearms program area, technical assistance, involves testing and evaluating firearms, ammunition and implements of war for proper classification under Federal law, and advising State, local and other Federal agencies on the technical aspects of firearms. We also trace firearms to assist Federal, State, and local law enforcement authorities. For example, in FY 1985, ATF received more than 44,560 requests for firearms traces from various law enforcement agencies. A total of 37,876 (85 percent) were successfully completed and the information transmitted to the requestor. Two notable traces are as follows:

> During FY 1985, ATF traced firearms recovered from members of The Order. Our trace of a semiautomatic pistol led to the determination that The Order was involved in the $3.5 million armored car robbery in Ukiah, California. The weapon was traced to an ex-CSA member of The Order.
>
> In another case involving The Order, a search of a member's residence turned up a number of firearms and explosives. A MAC-10 machine gun with no serial number was confiscated and found to be the weapon that killed Denver talk show host Alan Berg in June 1984. The serial number was lifted through a forensic process and the gun was traced to a former CSA member and paramilitary instructor of The Order.

The fifth and last area of the firearms program involves investigating relief from disability applications. During 1985, ATF completed 1,679 of these investigations.

Alcohol Program

ATF investigates criminal violations of the Federal Alcohol Administration (FAA) Act and sections of the Internal Revenue Code. Emphasis is placed on suppressing organized criminal infiltration of the legal liquor industry and the deterrence of large-scale manufacturers and distributors of non-taxpaid alcohol where State and local authorities have insufficient jurisdiction. ATF also provides training to State and local officers in illicit liquor investigative techniques.

To ensure fulfillment of our objectives, the Bureau has developed the following strategies:

> Target industry members for investigation where serious noncompliance with Federal laws and regulations is strongly alleged.
>
> Conduct FAA Act investigations, based upon significant allegations or intelligence, to ensure the integrity of State officials in control States engaged in the distribution of alcohol beverages.

Conduct legal alcohol enforcement training courses concentrating on violations of ancillary felony statutes, e.g., RICO, Hobbs Act and mail fraud.

The following are examples of the type of alcohol investigations that have already been conducted by ATF:

On December 6, 1985, the operator of a licensed distilled spirits plant pled guilty following a lengthy investigation. The 57 counts against the defendant related to $228,723 of Federal alcohol excise taxes which the defendant had avoided through false tax returns.

On May 23, 1985, a defendant pled guilty to the possession of 1,290 cases of Macorix and Ron Siboney Rum. This incident was part of a conspiracy to smuggle non-taxpaid Dominican rum into the United States through Miami to New York for distribution.

The alcohol program expends a minimal level of resources to investigate illegal "moonshining" activity. This illicit activity has been significantly reduced by the past efforts of the Bureau. However, as a result of the Deficit Reduction Act, PL 98-369, the distilled spirits excise tax has increased 19 percent from $10.50 to $12.50 a proof gallon in FY 1986. The tax change could trigger an increased incentive to illegally produce, import, and/or distribute non-taxpaid spirits. The program is closely monitored to determine any effects from the tax change.

Tobacco Program

Public Law 95-575 was enacted on November 2, 1978, to eliminate racketeering in the sale and distribution of cigarettes. Since that time, ATF has provided the leadership, technical expertise, and training which are necessary to enable States to develop their own contraband cigarette programs. During that same time frame, ATF also provided investigative assistance in complex, multijurisdictional tobacco tax frauds. Consequently, the States have developed enforcement capabilities to address the current problem and responsibility for the enforcement effort has been transfered to the States commencing FY 1987.

To augment the States' capabilities, ATF has provided training for State and local officers. During FY 1985, ATF developed a course for identifying counterfeit cigarette indicia. That course was presented to investigators in Illinois, New York, and Pennsylvania. In addition, ATF presented a 1-week contraband cigarette course to State officers at the Federal Law Enforcement Training Center in Glynco, Georgia.

The Advisory Commission on Intergovernmental Relations conducted two studies, one in 1975 and the other in 1984, of the contraband cigarette problem. They concluded that since the enactment of Public Law 95-575, the tax loss has dropped from 10 percent of the total revenue due States from their cigarette taxes to 5 percent. The majority of the remaining 5 percent is from activities outside of the purview of The Contraband Cigarette Act. These include small-scale bootlegging activities associated with military bases and Indian reservations.

Organized Crime Drug Enforcement Task Force Program

On October 14, 1982, President Reagan announced that 12 regional task forces would be created to implement a coordinated Federal effort against drug trafficking organizations. The task forces, designated as Organized Crime Drug Enforcement Task Forces (OCDETF), became fully operational during FY 1983. On October 1, 1984, the Florida Caribbean Task Force in Miami was added as the thirteenth Task Force. During 1985, ATF participated in 38 percent of all OCDETF cases. ATF special agents assigned to this program initiated 541 cases and submitted 277 criminal cases, recommending 444 defendants for prosecution. This represents a steady increase since the inception of the program.

ATF efforts in the task forces during Fiscal Years 1986 and 1987 will continue to be directed against violations of the Federal firearms and explosives laws committed by organized criminal groups whose principal income is derived from trafficking in illegal drugs.

The following cases are examples of significant results achieved by the Bureau's OCDETF participation:

> Nevada: On November 7, 1984, ATF agents and Las Vegas police arrested three people at the Sands Hotel as they delivered cocaine, valued in excess of $200,000, in exchange for 150 machine guns. The trio was arrested on State drug charges. A fourth suspect involved in the conspiracy agreed to assist authorities in arranging an undercover meeting with the main supplier of the cocaine. On November 8, 1984, ATF agents and Las Vegas police arrested two suspects subsequent to their delivering over 5 1/2 pounds of pure cocaine valued in excess of $1 million. Both men were arrested on charges of possession of cocaine for distribution.
>
> Florida: On May 20, 1985, a Federal search warrant was executed by OCDETF agents on a waterfront residence in Miami where automatic weapons and hand grenades were allegedly stored. Several items, including approximately one pound of plastic explosives, two hand grenades, 75 feet of safety fuse, nine fuse igniters, one submachine gun, and one .22 caliber pistol (threaded to accept a silencer and with an obliterated serial number) were

recovered. One suspect, who resided at the location, was arrested for violations of Federal firearms laws. Subsequent investigation disclosed that he had been offering the weapons and explosives for sale to drug smugglers for use in protecting their shipments.

Florida: On September 6, 1985, a major OCDETF target was sentenced in U.S. District Court in Miami to a total of 9 years incarceration and fined $7,000 as a result of his conviction for Federal firearms violations. The investigation by ATF established that he was a Colombian National illegally in the United States, and that he had acquired a number of firearms from licensed dealers by using a fictitious identity. DEA has identified this suspect as the leader of a large nationwide cocaine distribution network. He is also alleged to be responsible for numerous drug-related homicides in the Miami and New York City areas. This conviction was of particular significance because no other charges are pending against the defendant and his anticipated incarceration will have an extremely adverse impact upon his drug organization.

California: On October 28, 1985, a suspect was sentenced by the U.S. District Court in Los Angeles to 6 years in prison for manufacturing controlled substances and being a convicted felon in possession of firearms. This sentence was a result of a 2-year OCDETF investigation by ATF and the California Bureau of Narcotic Enforcement into outlaw motorcycle gang involvement in the illegal manufacturing and distribution of methamphetamine. The defendant was a significant manufacturer of methamphetamine and was believed to be a supplier of this drug to the Hell's Angels Motor Gang in San Bernadino, California. A series of six search warrants were executed on residences, storage lockers, and automobiles that were controlled by the defendant. Three complete drug laboratories and a quantity of drugs and firearms were seized.

Assistance to the United States Secret Service

During FY 1985, ATF expended approximately 15 staffyears in protecting candidates during the 1984 Presidential campaign. The commitment to the U.S. Secret Service protection responsibility will begin again in FY 1987 with preparation for the 1988 Presidential election campaign. As a result of candidate protection training, ATF will expend approximately 10 staffyears in FY 1987.

We willingly accept U.S. Secret Service requests for our assistance. Their confidence reflects on the professionalism of our field agents and this assistance has further reinforced our working relationship with our sister agency.

COMPLIANCE OPERATIONS

ATF has the responsibility of regulating several industries which market products that are sensitive in nature and subject to much public interest. It has been the Bureau's philosophy to regulate only in those areas which need to be regulated and then only to the extent necessary to achieve the intent of the law. We seek to reach a balance between effective administration of statutory requirements and the legitimate needs of industries under our jurisdiction.

The Bureau is extremely selective in setting goals because of our limited amount of resources. We ensure that these resources are efficiently used by concentrating our field work and regulation process on those areas which cause the most jeopardy to revenue collection or which pose the greatest threat to public safety.

To accomplish this objective, the Bureau's field offices continually assess and report on the compliance climate in their geographical jurisdictions. We then target our examinations to those entities where the greatest potential for noncompliance exists. Throughout the year, and especially at its conclusion, we analyze the progress made in our field programs, make necessary revisions, and identify new targets for the following year.

In addition to our regulation and field programs, we have adopted several other initiatives to increase compliance levels. We are improving the productivity of our employees by providing advanced training and by automating various activities in our offices. In all program areas, we conduct educational seminars which involve the active participation of industry members and State agencies. These seminars are creating an atmosphere in which our requirements are better understood and more likely to be complied with by all industry segments.

Alcohol Program

The Bureau's alcohol compliance program ensures that only legitimate persons enter the alcohol industry, the proper amount of excise taxes are paid, alcohol beverage labels accurately describe the product, and industry members do not engage in prohibited trade practices.

Qualification

ATF is responsible for keeping prohibited and unqualified persons out of the alcohol beverage industry. We achieve this goal in two ways. First, under our comprehensive qualification process, we issue permits only to those individuals who have the necessary business experience, are not statutorily prohibited, and are likely to comply with our requirements. Second, for entities already qualified and possessing permits, we ensure that they remain in compliance by conducting highly selective investigations to determine that no hidden ownership or illegal funding has occurred. The following are examples of how ATF's qualification program keeps prohibited persons out of the alcohol beverage industry.

> An inspector conducted an investigation in Texas which disclosed that the president of the applicant corporation had been deported from the United States in 1984 for narcotics violations. ATF informed the Immigration and Naturalization Service which then arrested the individual.
>
> During an application investigation of a California company, the inspector found that hidden ownership was involved. The hidden owner was a person who had previously had his import permit suspended for failure to pay excise taxes. As a result of the investigation, the application was withdrawn.

Tax Compliance

Historically, ATF has encouraged the alcohol industry to pay the proper taxes through a strong revenue examination program. In FY 1985, there were $5.2 billion in alcohol excise tax collections. We believe that the current rate of tax compliance is directly related to this effort and that we can only expect future compliance to be as good as the examination, verification and enforcement process. The following are examples of the findings of revenue examinations conducted by Compliance Operations field personnel.

> Inspectors conducted a revenue examination of a Kentucky distiller and found that it had underpayed excise taxes, kept fraudulent records, and falsified excise tax returns. The matter was referred to ATF Law Enforcement which, with the assistance of Compliance Operations inspectors, resulted in the criminal prosecution of the president of the distilling company and collection of $350,000 in delinquent excise taxes. ATF has claims against the assets of the distilling company, which has filed for bankruptcy in the interim. These claims are for $40,000 in additional delinquent excise taxes and $350,000 in penalties and interest.
>
> Compliance Operations inspectors and auditors recently completed a revenue examination during which they found that the distiller in Indiana had poor internal controls over taxable removals and had failed to pay taxes on overproof bottled products. These deficiencies were corrected and over $106,000 in additional taxes were collected.
>
> Compliance Operations inspectors conducted a examination of a distiller in Puerto Rico and found that the proprietor had claimed excise tax credits to which he was not entitled. The distiller has been assessed $143,000 to make up for the erroneously claimed items.

In support of examinations conducted at the premises of revenue producing plants, specialists in ATF regional offices review tax returns and other documents submitted by the revenue producers. These office reviews are an important part of ensuring that excise taxes are collected. The following is an example of the effectiveness of an office audit.

> A specialist in the Philadelphia regional office analyzed the exportation files of a distiller and found there was no documentation that the distilled spirits in question had been exported. ATF has assessed the distiller $184,700 for the taxes due.

ATF is maintaining an effective taxpayment compliance program despite decreasing staffing resources. The audit skills of inspectors have been increased by an active training program and by management insistence upon high standards. Advanced training, such as EDP and Cost Accounting, is being given to field employees so that they are better able to detect taxpayment deficiencies.

ATF also has a small but effective staff of professional auditors who conduct examinations of the largest and most sophisticated taxpayers, and who serve as a technical resource for other segments of the Bureau.

ATF continually monitors the compliance levels of its taxpayers and analyzes which types of examinations are more effective. We do this to realize the most efficient use of our limited resources. Our analyses show, for example, which segments of the alcohol beverage industry are likely to have lower tax compliance rates and which types of examinations are effective in detecting tax fraud. We then plan our compliance examinations based upon these analyses.

On October 1, 1985, the excise tax rate on distilled spirits was raised from $10.50 to $12.50 a proof gallon. In connection with this increase, a one-time floor stocks tax of $2 a proof gallon was levied on all distilled spirits in inventory on that date. We felt that unique approaches were necessary to ensure that the 300,000 potential floor stocks taxpayers would pay the proper amount of taxes.

The Bureau, therefore, conducted an extensive information campaign combined with a highly visible, concentrated examination program. All segments of the distilled spirits industry were informed of the excise tax increase and related floor stocks tax. ATF representatives also attended numerous industry meetings to inform the industry about the tax increases.

Along with these informational efforts, ATF inspectors conducted over 5,000 inventory verifications in October and November 1985 to ensure that industry members would pay the proper amount of floor stocks taxes which become due in April 1986. As a result of these examinations, over $917,000 in increasing inventory adjustments and special occupational tax collections were made.

We also believe this high visibility effort deterred some taxpayers from illegally evading floor stocks taxes and encouraged others to pay all that they owed. In-depth examinations will be conducted after April 1986, once the tax returns are filed, and after we have identified those taxpayers where potential noncompliance could have the most impact on revenue collections.

Alcohol Product Integrity

In July 1985, the Bureau learned that certain foreign wines might be contaminated with the hazardous substance diethylene glycol (DEG). ATF responded as a professional team: Headquarters and regional offices gathered information and organized field efforts, and field employees obtained nearly 2,000 imported wine samples for testing. As DEG contamination was found by the ATF Laboratory in over 80 different brands of imported wines, ATF employees again acted quickly to ensure that as little of the contaminated wine as possible reached consumers. Millions of wine bottles contaminated with DEG were, and are still being, recalled from the market to be destroyed, or returned to the foreign producer.

To protect and inform consumers, communications were established with industry, media, and State representatives. Inquiries from all sources were quickly and accurately answered. We believe that this incident involving diethylene glycol demonstrates the continued need for ATF's permit and label-approval requirements to ensure our continued ability to enforce quick and appropriate responses to protect the American consumer.

A program reduction of $1.6 million and 31 staffyears is proposed for FY 1987 in this subprogram, which oversees the enforcement of the Federal Alcohol Administration (FAA) Act. We plan to concentrate our reduced resources on shorter product integrity inspections in designated problem areas, such as contaminated wines.

International Actions

In 1985, the Bureau continued to play a major role in U.S. Government efforts to reduce or eliminate international barriers impeding U.S. alcoholic beverage trade. For example, ATF's technical and scientific expertise was instrumental in the European Economic Community's recent passage of revised regulations modifying the documentation requirement applicable to U.S. wines exported to the EEC. The modified requirements substantially reduce documentation costs and are expected to have a significant, positive impact on U.S. wine export trade with the Community.

ATF has also been working very closely with the Office of the U.S. Trade Representative in efforts to overcome the trade barriers existing in those countries targeted by the United States as having significant market potential for U.S. wine, distilled spirits and beer. In this connection, ATF technical support has played a key role in U.S. initiatives leading to the recent decisions by Japan and other targeted countries to reduce alcoholic beverage tariffs and harmonize the technical requirements applicable to these products.

In addition to its long-term efforts in international trade, ATF's role in dealing with the daily problems encountered by importers and exporters has brought about or maintained the flow of alcoholic beverages into domestic or foreign commerce. ATF's knowledge of domestic and foreign laws has enabled importers and exporters to supply their products timely and economically.

Market Integrity

To enforce the trade practice provisions of the FAA Act, the Bureau aggressively investigates allegations of significant violations, and our intent is to maintain an open marketplace. We concentrate our efforts on those industry members engaged in illegal interstate activities, leaving the less complex, intrastate violations for State agencies to resolve. Indicative of the success of this approach, during 1985, we accepted offers-in-compromise totalling $147,000 to resolve 13 cases.

For the past few years, we have held trade practice seminars throughout the country. The purpose of the seminars has been to increase the cooperation between ATF and State agencies and to increase the level of compliance by industry members. The 132 seminars held last year were very well received by both industry and State agencies.

Tobacco Program

ATF's tobacco compliance program is similar to the qualification and revenue protection aspects of our alcohol program. We screen applicants for permits and conduct qualification inspections to ensure that only eligible persons likely to comply with regulations enter the industry.

Field employees conduct revenue examinations at tobacco products factories and other locations to verify that all excise taxes have been paid. In FY 1985, $4.7 billion in tobacco excise taxes was collected.

On January 1, 1983, the cigarette excise tax was increased from $4 to $8 per 1,000. In connection with that increase, a floor stocks tax was assessed on all cigarettes in inventory at distributors' premises on January 1, 1983. Approximately $1.8 million in additional taxes, penalties and interest was collected as a result of the cigarette floor stocks tax examinations conducted by inspectors and auditors. In addition, two wholesalers pled guilty to criminal tax evasion charges, and a cigarette vending company was given a jeopardy assessment of $250,000.

Firearms Program

The Bureau's firearms program is based upon the Gun Control Act of 1968 and other statutes. Licenses are required to manufacture, import, and sell firearms. The intent of the statutes, and our qualification efforts, is to prevent statutorily prohibited persons from obtaining licenses. In FY 1985, our regional offices processed the following license actions: 112 applications were denied; 18 licenses were revoked; 892 applications were voluntarily withdrawn; and 905 applications were abandoned as a result of our requests for additional information.

A very important aspect of our firearms program is the support given to ATF special agents in their efforts to apprehend criminals and assist other law enforcement agencies. For this reason, inspectors frequently work with special agents in identifying criminals who purchase firearms and in investigating licensees who criminally misuse their license.

Inspectors also conduct compliance inspections of licensees previously identified as likely to violate the provisions of the firearms statutes. The purpose of these inspections is to prevent firearms dealers from making sales to prohibited persons and to ensure that a dealer's records are sufficient to trace the flow of crime guns when a law enforcement agency requires a firearms trace.

ATF's regional offices are responsible for processing firearms license applications and for maintaining the Bureau's firearms records files. In 1985 there were 248,800 firearms licensees. Regional offices processed over 90,000 applications, of which 37,400 were first-time applicants and 52,800 were renewals. Regional offices also responded to numerous requests for information from law enforcement agencies concerning the license status of individuals.

The Bureau has been making administrative improvements in the way it handles firearms applications and fees. During the summer of 1985, ATF instituted a "lockbox" for all firearms and explosives application fees. This "lockbox" approach funnels all applications and fees to a single location which, in turn, immediately deposits the money with the U.S. Government and then forwards the application documents to the appropriate regional office. The "lockbox" approach will save over $100,000 a year in processing costs and will accelerate the approval time of applications.

ATF is also responsible for enforcing the registration and revenue provisions of the National Firearms Act (NFA), a statute which regulates machine guns and gangster-type weapons The Bureau has automated its NFA registration files to handle registration information on over 223,000 NFA firearms and to more quickly act upon requests for information.

As in other program areas, the Bureau uses seminars for firearms licensees as a means of improving their understanding of and compliance with Federal laws. We actively involve State officials in putting on the seminars. Forty-three of these seminars were conducted last year and the response from the firearms industry has been very positive.

Explosives

ATF's explosives program ensures that licenses and permits are issued only to eligible persons, that records are maintained in order to permit traces of explosives used illegally and that explosive materials are stored safely and securely. Regional office personnel review all applications for accuracy and initiate criminal records checks to prevent prohibited persons from receiving a license or permit. Inspectors examine explosives storage facilities before license or permit issuance to make sure that the facilities meet stringent Federal requirements. The following are two examples of how our explosives program ensures that explosives are stored safely.

> An inspector conducted an explosives compliance inspection and found that the Oklahoma licensee had exceeded the limits for indoor explosives storage facilities and was storing 2,000 pounds of dynamite too close to an inhabited house. The inspector had the licensee move the explosives to a safe storage location.
>
> During another explosives compliance inspection, an inspector found that an explosives licensee in Ohio had 350 pounds of badly deteriorated dynamite in its storage facility. These explosives were safely and quickly destroyed by authorized personnel to prevent their accidental detonation.

After a person is issued an explosives license or permit, ATF inspectors conduct periodic compliance inspections. These inspections ensure that the storage facilities continue to meet ATF safety and anti-theft requirements, and that sufficient records are maintained to enable law enforcement officers to trace the movement of explosive materials.

Of particular concern to ATF is the safe storage of fireworks. The Bureau conducted two field tests of fireworks explosions in 1985. These tests indicate that some fireworks are more powerful than others and should be stored in more secure storage facilities. We are in the process of revising the Table of Distances to require fireworks to be stored farther away from inhabited buildings, roadways, and other explosives storage facilities.

Office Automation

To minimize the effects of staffing reductions and other shortages, ATF is carefully developing and implementing office automation. Many of the Bureau activities are being helped by the judicious use of computer technology. Inspectors and auditors now routinely use computers to assist them in completing assignments. Tasks such as developing graphs and trends, analysis of data for arson investigations, computing interest and penalty assessments, preparing reports of examination results, and generating random numbers are performed using these computers.

Field supervisors use software applications to monitor progress so that the Bureau's resources are most efficiently used. The status of examinations and inspections are monitored and reported to Headquarters on a monthly basis, and any necessary changes in program areas can be made quickly.

Regional and Headquarters offices also use computers on a regular basis. Although many of the applications are related to sophisticated word processing, computers also store voluminous reference information, perform complex calculations, and assist in detailed analyses.

EQUAL OPPORTUNITY PROGRAM

Finally, but by no means least important, are our equal opportunity activities of the Bureau.

Our primary effort continues to make equal opportunity responsibilities a performance standard of all executives and managers.

The Bureau has made outstanding progress over the last several years. This progress is due to the persistent support of affirmative action for minorities and women by management at all levels in the Bureau. The Office of Equal Opportunity has been extremely successful in this endeavor because of its ability to assist in recruiting qualified minority and women candidates to fill existing vacancies at all job levels. Of the 312 employees hired during FY 1985, 78 percent were minorities or women. The Bureau plans to continue its aggressive recruitment campaign to enhance the overall profile of minorities and women in our workforce.

In order to meet our obligations under the law mandating community outreach, the President's Initiatives on Historically Black Colleges and Universities, and the Federal Equal Opportunity Recruitment Program, the Office of Equal Opportunity was involved in continuous recruitment activities. Over 1,100 individuals were provided information on the Bureau and on application procedures for special agent and inspector positions. In addition, Bureau representatives made numerous presentations at colleges and universities.

Finally, under our recruitment program, the Office of Equal Opportunity has worked jointly with the Office of Law Enforcement to implement an

innovative Minority Impact Program to ensure the Bureau's commitment to full minority/female special agent representation and development.

Mr. Chairman and Members of the Subcommittee, this completes my statement. I will be happy to answer any questions you or Members of your Committee may have.

STATEMENT OF DAVID D. QUEEN

I am pleased to appear before you today in support of the annual appropriations request of the Bureau of Alcohol, Tobacco and Firearms for Fiscal Year 1987. I am testifying because Assistant Secretary Keating is unable to be here today. He is traveling with the Attorney General on a fact finding mission to Thailand, Burma, India and Pakistan, to investigate the problem of drug trafficking in and through that region.

With me today are the Director, Stephen E. Higgins, key ATF staff members, and Jill E. Kent, Deputy Assistant Secretary for Departmental Finance and Planning.

The budget request for Fiscal Year 1987 is $178,463,000 and 2,850 staff years. As you know, Mr. Chairman, this bureau has a multifaceted mission that includes both criminal enforcement and regulatory enforcement aspects. The ATF mission is to reduce the criminal misuse of firearms and explosives, including arson, to ensure the collection of all alcohol and tobacco tax revenues, and to regulate the alcohol beverage industry by effective enforcement and administration of the Federal Alcohol Administration Act.

Under the leadership of Director Higgins, ATF has carried out this mission in an effective and efficient manner. In response to our country's concerns about the cost of government and the need for deficit reduction, ATF has taken steps to reduce costs and achieve efficiencies wherever possible. The bureau has centralized administrative functions such as personnel and procurement, enabling it to close the five regional administrative offices. This is just one example of continuing efforts in the bureau to reduce overhead and operating costs.

At the same time that ATF has been reducing overhead costs and finding more efficient ways to carry out its programs, the bureau's program effectiveness has remained high.

A key example is the bureau's firearms and explosives program, under which ATF investigates a deadly criminal element comprised of narcotics violators, terrorists, organized criminals, and firearms smugglers. In Fiscal Year 1985, 55 percent of ATF's firearms defendants had a previous felony record, 60 percent were narcotics users or traffickers, 16 percent were armed at arrest and over 30 percent had a history of violence. The bureau also recovered 30,199 pounds of explosives, a 33% increase over Fiscal Year 1984. Lost or stolen explosives always have the potential for criminal misuse or use in terrorist activities.

The bureau's recoveries depict the high emphasis ATF places on explosives investigation and the recovery of explosive materials.

ATF maintains the nation's most competent civilian firearms technology staff and the National Firearms Tracing Center, which are crucial to Federal, State and Local law enforcement programs. During Fiscal Year 1985, the Center traced 44,943 firearms.

ATF is a full participating member of the President's Organized Crime Drug Enforcement Task Force. Because of ATF's unique jurisdiction and investigative expertise, the bureau plays a critical role in the overall success of the Task Force program. Although ATF has no direct statutory jurisdiction over narcotics violations, they take full advantage of their unique opportunity to suppress narcotics-related crime through the enforcement of Federal firearms laws. Because of a growing trend among narcotics traffickers to use and traffic in firearms in furtherance of their illegal enterprises, ATF has contributed significantly to these task forces. By the end of Fiscal Year 1985, ATF agents assigned to the 13 regional task forces had completed 277 cases against 445 defendants and had seized 1,662 firearms.

In addition to its criminal jurisdiction, ATF is responsible for regulation of the alcohol, tobacco, firearms and explosives industries and must ensure that all alcohol and tobacco excise taxes are collected. The taxes collected in Fiscal Year 1985 totalled $9.9 billion. ATF's regulatory role also requires that it ensure fair trade practices and maintain high levels of compliance with Federal laws.

In summary, Mr. Chairman, I am proud of the accomplishments of this bureau in its challenging and often dangerous work. We at Treasury appreciate the continued interest and commitment that your committee has demonstrated with regard to the ATF mission. This concludes my opening statement. I will now ask Director Higgins to provide you with his prepared statement, and we will then be pleased to respond to questions you or other members of the committee may have.

OPENING REMARKS BY MR. HIGGINS

Mr. HIGGINS. Mr. Chairman, let me thank you on behalf of the men and women in ATF for your efforts in renaming our headquarters building and for attending and speaking at the dedication ceremony; and also thank the other members of the committee for their support. That was nice of you to do, and people take great pride in it.

Thank you very much.

I would also like to congratulate Mr. Parkinson on his upcoming wedding. We know he has made a wise choice but we are waiting until the budget process is over to determine whether she did or not.

I am pleased to appear before you in support of the fiscal year 1987 budget request for the Bureau of Alcohol, Tobacco and Firearms. Accompanying me are my colleagues, Mr. William Drake, who is the Associate Director for Compliance Operations; Mr. Phillip McGuire who is the Associate Director for Law Enforcement; Mr. Chester Bryant, who is our Comptroller; and Mr. Paul Gentille, Financial Manager.

FISCAL YEAR 1987 BUDGET REQUEST

Our fiscal year 1987 budget request is for $178.5 million and 2,850 staff-years, which represents a net dollar increase of $11.7 million and a personnel decrease of 91 staff-years compared to our proposed authorized level for fiscal year 1986.

Our request includes program reductions of $4.7 million and 91 staff-years, offset by an increase of $8.9 million to maintain the current level of operations as well as the restoration of $7.5 million associated with the fiscal year 1986 Gramm-Rudman-Hollings reductions.

FISCAL YEAR 1987 PROGRAM REDUCTIONS

Two program decreases have been included in our fiscal year 1987 request. First, 60 staff-years and $3.1 million will be eliminated from the Law Enforcement Tobacco Program. Public Law 95–575 was enacted on November 2, 1978, to eliminate racketeering in the sale and distribution of cigarettes. Since that time, ATF has provided the leadership, technical expertise, training, and investigative assistance on complex, multijurisdictional tobacco tax frauds. Consequently, with our assistance, the States have developed their own enforcement capabilities, and responsibility for the program enforcement would be transferred to them commencing in fiscal year 1987.

The other program decrease includes 31 staff-years and $1.6 million from the Compliance Operations Alcohol Program. This reduction will be confined to the product and market integrity subprogram, which includes the enforcement of the Federal Aviation Administration Act. The Bureau aggressively investigates allegations of significant violations, and our intent is to maintain an open marketplace. We plan to concentrate our reduced resources on shorter, more intensive product integrity inspections in designated problem areas; such as contaminated wines.

Due to the enactment of the Gramm-Rudman-Hollings legislation, the proposed authorized level for fiscal year 1986 has been reduced by 4.3 percent, or $7.5 million, from the continuing resolution appropriation of $174.2 million and 2,941 staff-years. That leaves a revised level for fiscal year 1986 of $166.7 million and 2,941 staff-years. While the Gramm-Rudman-Hollings reductions will have a direct impact on all Bureau programs, we have attempted to minimize this impact by maintaining current staffing levels, focusing the reductions in operational areas rather than personnel. A detailed discussion of the impact of the Gramm-Rudman-Hollings cuts is contained in the fiscal year 1987 budget justification materials.

PRODUCTIVITY AND MANAGEMENT IMPROVEMENTS

Looking to accomplishments, during fiscal year 1985 and fiscal year 1986 to date, the Bureau has accomplished a great deal from both a managerial and programmatic standpoint. Efficiencies gained in our administrative processes have continued at a vigorous pace. This can best be illustrated by our successful efforts to completely centralize all administrative functions at headquarters, by implementation of the Federal Managers' Financial Integrity Act of 1982, and by our continued efforts to utilize services from other Federal agencies as well as the private sector to minimize the staffing required to effectively accomplish the Bureau's mission. These initiatives have led to what I believe to be a responsible application of valuable resources.

PROGRAM ACCOMPLISHMENTS

Our efforts and achievements are most evident in our program accomplishments where, as you know, we have a wide diversity of responsibilities. In law enforcement, our Firearms, Explosives, and Arson Programs have been particularly successful in combating bombings, narcotics trafficking, arson-for-profit, terrorism, and other crimes of violence. Nearly 4,000 suspects were recommended for prosecution during fiscal year 1985, including violent career criminals prosecuted under the new Comprehensive Crime Control Act of 1984.

Participation in the organized crime drug enforcement task forces [OCDETF] was expanded to the 13th task force city, Miami. I am proud to report that during 1985, ATF participated in 38 percent of all OCDETF cases, resulting in 444 defendants being recommended for prosecution.

To further enhance public safety, ATF has undertaken two new initiatives to address the increased threat of terrorism worldwide.

During fiscal year 1986, ATF began implementation of an international explosives incident data base I-EXIS, which will be able to compare both foreign and domestic explosives incidents. We also began training foreign law enforcement officials as a member of the State Department's Government-wide Antiterrorism Assistance Program [ATAP].

Efforts in the United States continue to focus on convicted felons who use firearms in violent crimes, violent domestic and international terrorist/hate groups, unscrupulous property owners who engage in arson-for-profit, and those who traffic in firearms, ammunition, and explosives in furtherance of criminal activities. ATF also targets illegal manufacture, transportation, and distribution of fireworks, where potential for disaster is enormous.

To complement this latter effort, our Compliance Operations Office is currently revising regulations to require fireworks to be stored farther away from inhabited buildings, roadways, and other explosives storage facilities to ensure public safety.

We also seek to protect the American consumer through laboratory analysis of alcoholic beverage samples; in fiscal year 1985, more than 80 different brands of imported wines were found to be contaminated with diethylene glycol, a hazardous substance. As a result, millions of bottles of wine were, and are still being, recalled from the market.

Compliance operations also concentrates field work and the regulation process on those areas which cause the most jeopardy to revenue collection. In order to ensure collection of over $10 billion in alcohol and tobacco excise taxes, we continually reassess local compliance climates and the effectiveness of each type of examination we perform. Inspector and auditor skills are being upgraded through advanced training such as automated data processing and cost accounting courses, and the use of computers to assist in financial analyses.

With the $2 increase in the excise tax rate on distilled spirits, and the one-time floor stocks tax at the beginning of this fiscal year, the Bureau combined an extensive information campaign with a highly visible concentrated examination program to verify distilled spirits inventories and ensure proper revenue collection due in April 1986. So far, these efforts have resulted in nearly $1 million in increasing inventory adjustments and special occupational tax collections. This figure will continue to grow for some time. The much more limited January 1983 cigarette floor stocks tax examinations resulted in $1.8 million in additional taxes, penalties, and interest.

I would like to emphasize that I have selectively discussed only a small portion of the accomplishments this Bureau has made during fiscal year 1985 and to date in fiscal year 1986. Our overall accomplishments by program are discussed in greater detail in my general statement, which was submitted for the record.

EQUAL OPPORTUNITY PROGRAM

Finally, but by no means least important, I would like to update our equal opportunity activities. We have continued to make significant equal opportunity accomplishments an important expectation of all executives and managers. Persistent support of affirmative action for minorities and women at all levels has been outstanding, as evidenced in the past year; of the 312 employees hired during fiscal year 1985, 78 percent were minorities and women.

With the continued support of the administration and Congress, particularly this subcommittee and your counterparts in the House, ATF will continue to deliver quality law enforcement and compliance operations efforts in fiscal year 1987 and beyond.

Mr. Chairman, that concludes my summary statement. My colleagues and I will be pleased to answer any questions you or other members of the subcommittee may have.

Senator ABDNOR. Thank you, Mr. Higgins.

If I could interrupt for a second, I would like to welcome a group of young people, the seventh grade class from Our Lady of Mercy School in Bethesda. One of the young men we know quite well because his father has a great South Dakota background, Mark Ruddy here, the first thing for a stamp of approval.

Just so that these young people know, this morning, we have a number of Treasury law enforcement agencies, including the U.S. Secret Service, the Bureau of Alcohol, Tobacco and Firearms, and the U.S. Customs Service testifying before the Senate Subcommittee on Appropriations regarding their budgetary requirements for fiscal year 1987.

The group at the table now is from the Bureau of Alcohol, Tobacco and Firearms. We just wanted you to know that.

You partially, or pretty well covered what Gramm-Rudman-Hollings did to you. I do want you to know I want a detailed report for the record, so members of the committee have a better understanding of the operational impact this legislation had on your organization.

Were you in the room when I was talking to Mr. Simpson about a freeze? I do not know yet, but we have reason to think they froze the budget at the 1986 level for some of our agencies.

IMPACT OF A FREEZE AT FISCAL YEAR 1986 LEVEL

If that is correct, what would a freeze do to you, and I think you ought to provide it for the record, information as to how ATF will be affected. We will need that information. But, offhand, what will a freeze do to you?

Mr. HIGGINS. I really hate to think about it, but, offhand, 79 percent of our budget is either for personnel or space, which are fixed costs. We are taking 4.3 percent from the other 21 percent. We have delayed a lot of things that we really needed. We canceled our purchase of cars and substantially reduced almost every nonpersonnel area so that we would not have to decrease personnel.

That strategy was somewhat predicated on some restoration of the Gramm-Rudman-Hollings reductions next year, as you can see in our budget request. If no money is restored and we have a freeze at the 1986 level, we would most likely have to take substantial reductions in the personnel area. This would have a dramatic impact on Bureau operations.

We will provide for the record more specific information.

Senator ABDNOR. We will be working with you on that.

REDUCTION OF INTERNAL REVENUE SERVICE REIMBURSEMENT

The ATF is reducing reimbursement to the Internal Revenue Service [IRS] for processing special tax returns. What does that entail and will it reduce revenue collection?

Mr. HIGGINS. For a number of years we were part of IRS, but Executive Order 221, effective July 1, 1972, established us as a separate Bureau. IRS continues to provide to do the paper work, the data processing, and all of the collection activity, including the deposit of all retail and excise taxes. We had been reimbursing them for these services. There are some legal questions about whether or not we should be reimbursing them or not. But this year, in terms of trying to effect the Gramm-Rudman cuts and review our priorities, this is one of the areas we were forced to substantially reduce.

My understanding is that they continue to process those returns, or at least have a limited processing of those returns, and I think from that standpoint there would be no adverse revenue impact. That is my best understanding. But IRS will have to answer, or maybe Ms. Kent.

Ms. KENT. That is correct. IRS will be processing it without reimbursement. There will be no revenue loss.

Senator ABDNOR. OK.

FISCAL YEAR 1987 STAFFING REDUCTION

The budget proposes a reduction of 91 positions; 31 of those will come from the compliance alcohol area. Considering the recent tax increase on distilled spirits and cigarettes and talk of possible increases for excise taxes and beer and wine, that does not sound like a very sound policy. Do you have any reaction to that?

Mr. HIGGINS. I believe that this is one of those situations where all the bureaus in Treasury are competing for a limited amount of dollars. After evaluating our priorities, we have decided to try to take those cuts in the nontax areas. We are taking them in the Federal Alcohol Administration Act area, which basically relates to trade practices, advertising, and labeling, as opposed to our Revenue Collection Program.

EXCISE TAX RATES

Senator ABDNOR. While we are on that subject, the tax proposal now being considered by the Senate Finance Committee includes a statement which says, "The wine excise tax rates would be made equivalent to the beer excise tax (on all alcohol content basis)." With thousands of wines of different alcohol contents, and hundreds of different beers at different alcohol contents; how would you enforce that new tax if it comes into being?

Mr. HIGGINS. I have seen that proposal. I would have to say it would be very difficult because of the different percentages of alcohol contents that would have to be compared for the various kinds of beers and wines.

If all beers and wines had the same alcoholic percent, then it would be relatively easy to raise the wine tax to the beer tax, but that is not the case. Beers range from 2 percent to probably 7 or 8 percent. Wines range from 7 percent to 24 percent. And I do not know how you would make them equivalent on an alcohol tax basis, without having a different tax rate for almost every brand you have.

Senator ABDNOR. One of us should bring that to the attention of the Senate Finance Committee.

Mr. HIGGINS. The Department may want to.

TRANSFER OF TABACCO PROGRAM TO THE STATES

Senator ABDNOR. The positions are being reduced in the Tobacco Program. Can the States handle the enforcement responsibility if this reduction is made?

Mr. HIGGINS. I am reluctant to speak for the States. I suspect the States would say no, they would not be able to. We feel that with the amount of training we provide and our continuing effort to make some of our laboratory facilities available, as well as the auditing handbooks that we provided them, we believe they would do a good job. Therefore, from our perspective, we think they could, but, they may not agree.

Senator ABDNOR. Do most States have the manpower, or is this going to start from the bottom up?

Mr. HIGGINS. I am not sure they all have adequate resources. Some have the manpower and have been relying partially on our resources. But, as they obtained more training and new budgets, I think they have supplemented their resources.

TAX REVENUE COLLECTIONS

Senator ABDNOR. Between budget reductions in the Alcohol Program, and generally hard times in the alcohol industry itself, do you anticipate any impact on tax revenues?

Mr. HIGGINS. I am going to turn that question to Mr. Drake with just a little preface. We believe that we have had a very, very high rate of compliance, because of a couple of things that are unique in this industry, as opposed to income tax.

One is that it is a controlled industry to enter into. That means that we do background checks and approve permits and licenses for people going into this business. We have a very good method for screening people who come into the business.

We have also had, we believe, a very effective audit program, accomplished by auditors and inspectors who know the industry well and know where to look for things that might go wrong. We think that combination has given us a high compliance rate.

I think there are indications that because of the hard economic times and other factors, and maybe because of some of the cuts we have made over the past few years, we may be having some increasing problems, and it is hard to quantify. Having said that, I am going to turn it over to Mr. Drake.

Senator ABDNOR. Mr. Drake, why don't you grab that mike.

Mr. DRAKE. Mr. Chairman, as the Director pointed out, for a variety of reasons, there have been some decreases in the consumption pattern. Because of alcohol abuse concerns, drunk driving concerns, and the tax increase that went into effect October 1, the industry is having some difficult times.

In the past 3 years, we have had 30 bankruptcies. It has never happened in that industry up until this time.

We are seeing things occur now that never occurred in the past. This includes such things as actual fraud schemes, people not paying their excise taxes, of such high figures as $1.5 million, people filing their returns late with the reason being they have cash flow problems, and people having removals that they are not recording. Some of these are human errors, but we are not there in their presence as we have been in the past, so the human error does not get caught. Some of these are intentional because they have needs to pay other things. And because of the awareness that we may not be present, as frequently as we were, or as thoroughly, they take shortcuts, and it costs the Government money. It reduces the taxes we collect.

We have seen claims filed that are fraudulent. We have seen errors made that, given the benefit of the doubt, were accidental. They still result in less taxes being collected by the Government.

Looking at the fact that we collect around $10 billion, even a 1-percent loss comes out to about $100 million. That is a considerable amount of money.

Our experience with the special occupational tax area, where the compliance, because we are not involved as much, is around 60 percent. By comparison if I withdraw totally from the excise tax area, I wouldn't project a 40-percent decrease, but I think the decrease would be significant.

Senator ABDNOR. Thank you, Mr. Drake.

Now, if you are deferring your ADP plan, I want to say I am concerned that we insist on reducing revenue collection possibility. We seem to have considerable inconsistency here. We increase IRS; decrease ATF. We see the same when it comes to drug enforcement. We increase the FBI and DEA while cutting Customs. I just want the record to note that we are going to discuss this issue with Mr. Miller when he comes up next month. We do have the budget of the office and management under us. It does give us a little opportunity to have discussion on some of these issues.

ADDITIONAL COMMITTEE QUESTIONS

So, we thank you very kindly, Mr. Higgins, you and your colleagues. We will be submitting additional questions for the record.

Mr. HIGGINS. Thank you, Mr. Chairman.

Senator ABDNOR. Thank you.

[The following questions were not asked at the hearing but were submitted to the Bureau for response subsequent to the hearing:]

Additional Committee Questions

HANDGUN LEGISLATION

Senator Abdnor: Every member of this Subcommittee voted for and supported S. 49 when it passed the Senate last summer. Several weeks ago some of your personnel were quite outspoken with their objections to the legislation and were quoted in the public press. I hope you can assure me that this type of conduct is a thing of the past.

Mr. Higgins: The position of this Bureau is quite simple: we support S. 49. Statements to the contrary, regardless of whom they are attributed to, are inaccurate.

All ATF employees are aware of, and adhering to, our policy of support for S.49.

G-R-H REDUCTIONS

Senator Abdnor: Your request for FY 1987 does not include adjustment for Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen? would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

Mr. Higgins: ATF has been involved with rebuilding its work force following the loss of large numbers of employees during the proposed abolishment of the Bureau in fiscal years 1982 and 1983. As a result, the cuts proposed by Gramm-Rudman-Hollings in FY 1986 have been directed at operational funds rather than personnel, in order to minimize the impact on employee morale and the resulting loss in productivity and mission accomplishment. The reduction of $7.5 million in FY 1986 was realized through spending curtailment in tax collection services, equipment, travel, automation, permanent change of station moves, purchase of evidence, vehicle replacement, etc.

We could not sustain the same base in FY 1987 because a large portion of our request is to meet mandatory cost increases of items which by definition are nondiscretionary and will be paid at the higher rate in FY 1987.

If the 1986 reductions are applied in 1987, the Bureau would immediately put a freeze on all hiring, eliminate all temporary personnel from the rolls and initiate a reduction-in-force effective January 1, 1987. As a result of these actions the Bureau would lose approximately 400 employees, which translates into an average position reduction of over 200 (7 percent below the President's Budget). Staffing reductions of this magnitude will adversely affect all Bureau programs during FY 1987. The overall impact will culminate in the potential loss of revenue related to uncollected taxes and diminished public safety.

Senator Abdnor: Have you reached the 135 square foot goal? If not, why and what is your target date?

Mr. Higgins: We believe that we are within the 135 square foot goal. We cannot be certain, however, until such time as the General Services Administration formally provides this Bureau with supplemental space factors.

Background

Executive Order 12311, Government Work Space Management Reforms, was issued in March of 1983. The main thrust of this order is to improve the management and performance of federal work space.

Executive Order 12512, Federal Real Property Management, published in April of 1985, decreed that real property be managed as an asset.

In the summer of 1985, these two executive orders were followed by Temporary Regulation D-71, Work Space Management Reform. This regulation requires agencies (Treasury Department) to achieve an average utilization rate of 135 square feet by 1990, and to prepare annual work space management plans which will be reviewed by both the General Services Administration (GSA) and the Office of Management and Budget (OMB). Temporary Regulation D-71 recognizes that various agencies have different duties and scope of work. To accommodate these variations a supplemental space policy has been developed whereby an agency may deduct certain non-workstation office space when calculating office utilization rates.

The supplemental space factors and percentages will be developed by each agency in cooperation with a GSA contractor. Following receipt of recommendations from the contractor, GSA will enter the data into its information systems and provide formal notification of supplemental space factors and percentages to each agency.

QUESTIONS SUBMITTED BY SENATOR WILLIAM PROXMIRE

BACKGROUND

Before addressing each of the five categories of questions, we believe that a brief discussion of the statutory and regulatory background of ingredient labeling is necessary.

As you may be aware, the Bureau of Alcohol, Tobacco and Firearms (ATF) has broad authority under section 5(e) of the Federal Alcohol Administration Act (FAA Act), 27 U.S.C. 205(e), to prescribe regulations with respect to the labeling of alcohol beverages as will, among other things, prevent consumer deception and provide the consumer with "adequate information as to the identity and quality of the products". Pursuant to this statutory authority, ATF has promulgated regulations requiring labels of alcohol beverages to reveal the identity, quality, and, in certain cases, the alcoholic content of the products. 27 C.F.R. Parts 4, 5, and 7. However, at no time from 1935, the date of the enactment of the FAA Act, until 1980 had the regulations required the labeling of ingredients used in alcohol beverages.

ATF first considered the utility of ingredient labeling for

alcohol beverages in August 1974, and February 1975, when it published ingredient labeling proposals. Public hearings on the issue were held in April and May 1975. After extensive study of the views of industry representatives, consumer groups, and non-industry experts, including review of over 1,000 written comments, ATF withdrew its ingredient labeling proposals in November 1975. 40 Fed. Reg. 52,613 (1975).

Thereafter, in 1979, ATF again issued a notice of proposed rulemaking with respect to the labeling of alcohol beverages. During the comment period following the issuance of the notice, ATF received 1,873 comments from consumers, special interest groups, industry members, doctors, Government agencies, and members of Congress. Approximately 75 percent of the comments opposed mandatory ingredient labeling for alcohol beverages.

However, on June 13, 1980, T.D. ATF-66 was published requiring that labels of all domestic and imported alcohol beverages disclose either the essential ingredients of the product or an address where this information could be obtained. 45 Fed. Reg. 40,538 (1980). The labeling requirement was to become mandatory on January 1, 1983. While ATF in T.D. ATF-66 adopted partial ingredient disclosure, T.D. ATF-66 also emphasized the "uncertainties in the data underlying the health and cost benefits of ingredient labeling". 45 Fed. Reg. 40,540.

On February 15, 1981, President Reagan issued Executive Order No. 12,291, 46 Fed. Reg. 12,193 (1981), which directs each Federal agency to review existing regulations so as to maximize the benefits to society while at the same time imposing the least burden to achieve those benefits. As a result of the review of existing regulations called for by the executive order, ATF issued a notice proposing to rescind the ingredient labeling regulations as not being in accord with the Presidential mandate. 46 Fed. Reg. 24,962 (1981). After considering comments which addressed the difficulties of compliance, the deceptive nature of ingredient labeling, and the minimal impact on the public health, ATF published 46 Fed. Reg. 55,093, on November 6, 1981, rescinding the labeling requirements issued under T.D. ATF-66. As will be discussed below, this regulation was subsequently invalidated by the United States District Court for the District of Columbia.

On June 17, 1983, ATF decided to re-examine the ingredient labeling issue and published another notice of proposed rulemaking. After consideration of the 1,840 comments submitted in response to this notice by consumers, special interest groups, industry members, physicians, and Government agencies and after review of the previous rulemaking records from 1974, ATF promulgated T.D. ATF-150, 48 Fed. Reg. 45,549 (October 6, 1983), a rule which again rescinded T.D. ATF-66. T.D. ATF-150 went further than merely rescinding T.D. ATF-66, however, since it also required the disclosure of the color additive FD&C Yellow Dye No. 5 on labels of alcohol beverages and also indicated that ATF would consider requiring the labeling of other ingredients on a case-by-case basis. As discussed in great detail in T.D. ATF-150, a copy of which is enclosed herewith, ATF's decision to require case-by-case labeling was based on an administrative record which revealed the misleading nature of across-the-board labeling of ingredients used in alcohol beverages as well as ambiguous data concerning the usefulness of such labeling; the minimal desire by the consumer for such labeling; the failure of the record to establish that ingredients on alcohol beverages pose general health hazards; the uncertainty of the health problems associated with any particular ingredient (with the exception of the additive FD&C Yellow Dye No. 5), and conflicting evidence as to whether labeling cures the health problem; the ineffectiveness of the address label option required in T.D. ATF-66; and, as a matter of secondary consideration, the costs associated with labeling. As noted in T.D. ATF-150, even T.D. ATF-66 had acknowledged that the evidence with respect to a number of these same factors was very uncertain and could lead to widely different conclusions concerning whether ingredient labeling for alcohol beverages is necessary.

STATUS OF THE COURT CASE

In June 1980 the Bureau of Alcohol, Tobacco and Firearms issued a requirement requiring ingredient labeling for beer, wine and distilled spirits. In 1981 and again in 1983 you proposed rescinding this regulation and have been taken to Court twice by the Center for Science in the Public Interest. While that case has been pending, this Committee has repeatedly included language in its report prohibiting the Bureau from implementing the ingredient labeling regulation until the case has been resolved.

Senator Proxmire: I understand that the District Court has now ruled against the Bureau twice. Is that correct? And what was the basis for the Court's ruling in each case?

Mr. Higgins: Yes, the District Court for the District of Columbia has ruled against ATF in two separate actions brought by the Center for Science in the Public Interest. In Center for Science in the Public Interest v. Treasury. 573 F. Supp. 1168 (D.D.C. 1983), the district court invalidated T.D. ATF-94, the rule which had first rescinded T.D. ATF-66, on grounds that T.D. ATF-94 did not adequately explain the basis for the rescission of T.D. ATF-66 and that ATF had placed undue emphasis on cost factors. In 1985, the district court invalidated T.D. ATF-150 on grounds that the rule was identical to T.D. ATF-94 which had been invalid as well as on grounds that the rule was unsupported by the record and impermissible relied on costs. The district court also ordered ATF to announce a date upon which T.D. ATF-66 will again be mandatory. See Center for Science in the Public Interest v. Treasury, No. 84-2079, slip op. at 12, 13 (D.D.C. October 30, 1985).

Senator Proxmire: With two Court rulings against the Bureau, what is the basis for your appeal to the Court of Appeals?

Mr. Higgins: ATF's appeal of the district court's invalidation of T.D. ATF-150 is based on grounds that the court's findings are in error in two respects. The decision to rescind indiscriminate ingredient labeling of alcohol beverages in favor of the case-by-case approach was a new rulemaking procedure and a well-reasoned exercise of ATF's rulemaking discretion based on all of the evidence in the administrative record. An examination of the bases and purpose statement in T.D. ATF-150 indicates that ATF considered appropriate factors in promulgating the rule. In addition, the district court erred in ordering ATF to reinstate T.D. ATF-66, rather than remanding the matter to ATF for further action. Case law demonstrates that courts are without authority to usurp the agency's rulemaking function.

Senator Proxmire: When do you expect the Court of Appeals to hear this case? Is it fair for the Committee to assume that the Court of Appeals should resolve this issue by the end of the year?

Mr. Higgins: The Court of Appeals has placed this case on an expedited schedule. Briefing was completed by the parties in March 1986. While the Court of Appeals has not yet set a date for oral argument, it did indicate that it would endeavor to hear this case during its May-June 1986 calendar. Thus, we believe that this matter could be decided by the Court of Appeals before the end of 1986.

HEALTH BENEFITS

Senator Proxmire: In your decision to rescind the ingredient labeling regulation your agency stated in its Federal Register notice that there are uncertainties "whether there are allergic reactions to alcoholic beverages." Is that still the agency position?

Mr. Higgins: Concerning the evidence with respect to allergic reactions to alcohol beverages, ATF had determined, as explained in T.D. ATF-150, that the administrative record did not support the conclusion that ingredients used in alcohol beverages pose any general health hazard, pointing out that only ingredients approved by the Food and Drug Administration (FDA) may be used in the production of alcohol beverages. The rule further stated that there was no clear evidence in the record that any one ingredient used in alcohol beverages (with the exception of FD&C Yellow Dye No. 5) posed a recognized health hazard. As indicated in T.D. ATF-150, the comments submitted by medical experts revealed uncertainties in the data regarding the number of individuals who might have allergic reactions to ingredients in alcohol beverages and the severity of those reactions. Many of the medical commentators advised that the labeling of all ingredients would have little or no real value for allergy sufferers. ATF still believes, as stated in T.D. ATF-150, that the best approach in this uncertain health area is not to require general ingredient labeling to attempt to deal with unknown and unqualified problems, but rather to address, on a case-by-case basis, specific ingredients and their health effects and then determine what appropriate action should be taken. 48 Fed. Reg. 45,551.

Senator Proxmire: In testimony before the House Energy Commerce Committee, you testified that "ATF doesn't have the health and safety experts that are resident in the Food & Drug Administration...We do, then look to the Food & Drug Administration, as we have for 50 years, to pass on the health and safety aspects of various ingredients used in alcoholic beverages." Yet the FDA commented on your decision to rescind ingredient labeling that "reliance of ingredient declaration may be the only practical means for consumers to avoid offending substances." Why have you not deferred to FDA's expert opinion on ingredient labeling of alcoholic beverages?

Mr. Higgins: Concerning the comment submitted by the FDA during the notice and comment period which preceded the publication of T.D. ATF-150, we would emphasize that the comment was considered by ATF in its full context. In connection with the allergy issue, the FDA advised that no reliable estimate is available about the number of individuals who suffer allergies to ingredients in alcohol beverages. The FDA then stated that "once sensitivity to ingested substances has been confirmed, the...ingredient declaration may be the only practicable means for consumers to avoid offending substances". Thus, far from ignoring the FDA's comment, it is clear that the case-by-case labeling approach adopted in T.D. ATF-150, which examines the health effects of specific ingredients, and requires ingredient labeling where appropriate, fully meets the concerns expressed by the FDA.

At this point, we believe it instructive to briefly discuss the nature of the interrelationship between ATF and FDA as it pertains to the production and labeling of alcohol beverages. As indicated in T.D. ATF-150, with respect to production, all ingredients used in alcohol beverages must be approved for use by the FDA. Consequently, ATF is continually referring to the FDA regulations for guidance on the acceptability of the ingredients used in alcohol beverages and is in frequent contact with FDA personnel.

The nature of the relationship between the agencies with respect to labeling of alcohol beverages is of a different nature. While the FDA is under a statutory mandate to require ingredient labeling of food products under certain circumstances (21 U.S.C. 343(i)), the FAA Act does not similarly mandate that ATF require ingredient labeling of alcohol beverages. The FDA has historically deferred to ATF and its predecessor in the areas of labeling and advertising of alcohol beverages. Moreover, the United States District Court for the Western District of Kentucky has specifically ruled that the FDA does not have concurrent jurisdiction with ATF over the labeling of alcohol beverages. Brown-Forman Distillers Corp. v. Mathews, 435 F. Supp. 5 (W.D. Ky. 1976).

Nevertheless, as indicated above, ATF does look to the FDA for guidance in making determinations concerning the need to require disclosure of a particular ingredient on labels of alcohol beverages, and has demonstrated full concern for the public health in promulgating rules requiring the labeling of FD&C Yellow Dye No. 5 and saccharin, and in proposing a rule that would require the labeling of sulfiting agents.

Senator Proxmire: The Treasury Department stated in 1980 that the government consultant hired to conduct a regulatory analysis "found 'strong evidence' in the medical research literature that indicated ingredients used in the alcoholic beverages can cause adverse health effects in humans...while most effects are not necessarily severe some are severe". What changed between 1980 and 1983 when your agency concluded that there were uncertainties about these health effects?

Mr. Higgins: It should be emphasized that ATF's findings in T.D. ATF-150 were not as different from those in 1980 as it might appear. In T.D. ATF-66, ATF acknowledged "the uncertainties existing in the data underlying health and consumer benefits" and was concerned about those uncertainties. 48 Fed. Reg. 45,555. Moreover, even the consultant's study referred to in T.D. ATF-66 (the BDM study) stated that the allergy issue was unclear. For example, in its summary of health problems, the BDM study noted that "neither a review of the research literature nor consultation with medical and health professions provides adequate information concerning the extent of adverse health effects of alcohol beverage ingredients" (page IV-11). Thus, ATF acknowledged the uncertainties with respect to the health issue which has existed on all prior rulemaking records on ingredient labeling and concluded in T.D. ATF-150 that the case-by-case approval was a more reasonable approach to health concerns.

Senator Proxmire: Will you provide for the record a copy of that government-sponsored report?

Mr. Higgins: A copy of the BDM study is enclosed as requested. (The copy is being retained in the subcommittee files.)

CASE - BY - CASE APPROACH

Let's take a closer look at your case by case approach to labeling. While you require labeling of yellow dye #5 and saccharine and have proposed labeling of sulfites, critics charge that they demonstrate the agency's lack of concern for the public health. For example:

* you only moved to require basic labeling of yellow #5 in 1983 -- four years after FDA required conspicuous labeling of yellow #5

* your decision to require saccharine labeling is nothing more than compliance with Saccharine Labeling Act of 1977, which mandated labeling

* you are only now proposing to require basic labeling of sulfites; by contrast:

-- FDA has always required labeling of sulfites in food when used as a constituent ingredient

-- FDA is now requiring more extensive labeling of sulfites when used as additives of constituent ingredients of foods

-- FDA is now even proposing to ban certain uses of sulfites

Senator Proxmire: Far from promptly following FDA's lead, the Bureau appears to be doing little as possible as late as possible. By definition, critics charge that your policy requires reports of serious illness or, in extreme cases such as sulfites, death before the Bureau acts. How do you respond to those criticisms?

Mr. Higgins: We would assert that those criticisms alleging failure to respond in a timely fashion to public health issues in implementing case-by-case ingredients labeling for alcohol beverages on the part of ATF are without merit. T.D. ATF-150 emphasizes ATF's commitment to examine the necessity of mandatory labeling of ingredients on a case-by-case basis through its own rulemaking initiative or on the basis of petitions for rulemaking. 48 Fed. Reg. 45,555. As demonstrated below with respect to the publication of the rules requiring the labeling of FD&C Yellow Dye No. 5 and saccharin, and in proposing a rule requiring the labeling of sulfites, it is clear that ATF's response to public health concerns has been timely.

For example, ATF commenced a study concerning the need to disclose the use in alcohol beverages of the color additive FD&C Yellow Dye No. 5 in 1979, shortly after the FDA promulgated its final rule requiring the disclosure of this additive on food and drug labels. Since the FDA rule limited its discussion of health consequences to the ingestion of food in general, ATF deemed it necessary to determine the extent of the use of this additive in alcohol beverages as well as the number of persons affected by such use. After consultation with its national laboratory, ATF determined that the beer and wine industry rarely used FD&C Yellow Dye No. 5 (1 percent or less) and that the distilled spirits industry uses the additive in certain cordials (approximately 1 to 5 percent of the market). Based on this and other research data, ATF further determined that only a small percentage of the entire alcohol consuming population (between 350 and 2,000 persons) would be affected by FD&C Yellow Dye No. 5. Nevertheless, in 1980, ATF did require the disclosure of FD&C Yellow Dye No. 5 on labels of alcohol beverages in its promulgation of T.D. ATF-66. Although this rule was subsequently rescinded by ATF in 1981, ATF took a fresh look at the medical and other evidence on the administrative record and in 1983 again required the disclosure of FD&C Yellow Dye No. 5, as stated in T.D. ATF-150.

With respect to the required disclosure of saccharin on labels of alcohol beverages, T.D. ATF-220 explains that ATF determined that there was a need to consider the labeling of saccharin when members of the alcohol beverage industry began petitioning ATF to use the sugar substitute in the production of alcohol beverages. 50 Fed. Reg. 51,851 (December 20, 1985). ATF then determined that the FDA regulations do not prohibit the use of saccharin in alcohol beverage products. ATF further concluded, however, that the use of saccharin should be disclosed on alcohol beverage labels pursuant to section 5(e) of the FAA Act which requires that adequate information be given to the alcohol beverage consumer and in recognition of the policy behind the Saccharin Study and Labeling Act, 21 U.S.C. 343, which statute is not administered by ATF.

Finally, ATF's response to the issue of disclosing the use of sulfiting agents on labels of alcohol beverages has closely followed the FDA's proposed action. On April 3, 1985, the FDA issued a notice (50 Fed. Reg. 13,306), proposing that where the level of added sulfur dioxide or sulfiting agents in finished foods and non-alcohol beverages equals or exceeds 10 parts per million, expressed as total sulfur dioxide, disclosure would have to be made in labeling. On June 24, 1985, ATF published a notice (Notice No. 566, 50 Fed. Reg. 26,001), similarly proposing the disclosure of sulfiting agents on labels of alcohol beverages containing 10 or more parts per million total sulfur dioxide. Contrary to the criticism raised in the above question, it was not until August 26, 1985, well after ATF had commenced rulemaking on the sulfite issue, that ATF received a report from the FDA linking serious illness or death to the isolated variable of ingestion of wine containing sulfites.

Senator Proxmire: When does the Bureau expect to have the ingredient labeling requirements for sulfites finalized?

Mr. Higgins: The comment period on the proposed sulfite rule ended on December 23, 1985, and ATF is currently in the process of reviewing 515 comments submitted by industry members, consumers, public interest groups, and medical and health commentators on this issue. ATF anticipates that a final rule will be issued in June 1986.

We would also emphasize that the sulfite rule, as currently proposed by ATF may be affected by a proposed rule issued by the FDA on August 14, 1985 (50 Fed. Reg. 32,830), which would prohibit the use of sulfiting agents on raw fruits or vegetables. This notice also indicates an intent to address other uses of sulfites, including their use in the production of alcohol beverages. ATF is following FDA's rulemaking very carefully and is in frequent consultation with the FDA on this matter.

Senator Proxmire: Does the Bureau have any other ingredients under consideration for ingredient labeling under your case-by-case approach? Which ones?

Mr. Higgins: ATF is not considering the mandatory labeling of any other ingredients at this time but stands at the ready to entertain petitions and to exercise its own rulemaking initiative when circumstances dictate.

Senator Proxmire: The FDA has identified numerous ingredients, besides Yellow Dye #5, saccharine and sulfites, that cause adverse reactions. These include grains, yeast, fruits, molasses, spices, egg whites, fish glue. In addition, the medical literature identifies other ingredients -- flavoring agents, coloring agents, and preservatives -- that can trigger adverse health reactions. Do you have plans to require labeling in each of these cases? If not, why not? Former FDA Commissioner Don Kennedy noted that "A quick glance at a list of ingredients could prevent unnecessary pain and suffering and increase consumer awareness of the composition of various beverages." Should you not follow FDA's lead?

Mr. Higgins: Concerning the labeling of ingredients such as grains and yeast, T.D. ATF-150 explains that the indiscriminate labeling of such ingredients, as required by T.D. ATF-66, would be misleading and of little use to the consumer. The evidence in the rulemaking record showed that because of the substantial transformation that takes place in alcohol beverages from beginning to end of the production process, ingredient listings would be misdecriptive of the end product. In contrast to most food products, the chemical/biological changes that occur during fermentation and distillation change many ingredients, such as grains and yeast, to the extent that they are radically altered or do not exist in the finished products. Nevertheless, consumers seeing references to such substances on the labels of the finished products might erroneously believe that the finished products contain these substances--or at least retain the properties associated with them. In addition, individuals with sensitivity to such substances may unnecessarily refrain from consuming the products believing these substances continue to be present in the product. 48 Fed. Reg. 45,550. Therefore, contrary to the FDA view with respect to the labeling of food products, an across-the-board listing of essential ingredients on labels of alcohol beverages would not increase consumer awareness of the composition of various beverages.

EXISTING REGULATIONS

In your agency's 1983 decision to rescind ingredient labeling regulations, you stated that "the Department believes that existing regulatory requirements provide adequate information as to the identity and quality of the alcoholic beverage."

Senator Proxmire: To what existing regulations are you referring? There does not appear to be any regulations requiring labeling except for yellow dye #5, saccharine and the proposed rule for sulfites.

Mr. Higgins: Concerning the regulations pertaining to alcohol beverages, T.D. ATF-150 did conclude that existing statutory and regulatory provisions generally provide consumers with sufficient information and protection. The regulations pertaining to the labeling of alcohol beverages appear at 27 C.F.R. Parts 4, 5, and 7. More specifically, ATF has established class and type designations, known as standards of identity, for distilled spirits and wine which generally identify the basic agricultural ingredients and sets forth the parameters of production and alcohol content. See, 27 C.F.R. 4.21-4.25 and 5.22. Any product not having a standard of identity must bear a truthful and adequate statement of composition on the label which discloses the major components of the product. Furthermore, the FAA Act itself specifies the ingredients contained in malt beverages. 27 U.S.C. 211(a)(7).

There are also specific requirements in the regulations for labeling of coloring or flavoring, as well as the percentage of neutral spirits in distilled spirits. 27 C.F.R. 5.32. Moreover, if a wine or distilled spirits product contains coloring agents or artificial flavors, special labeling is required. 27 C.F.R. 4.21(h)(1) and 5.39.

T.D. ATF-150 further concluded that the statutory requirements for qualification of premises (26 U.S.C. 5171, 5351, and 5401) together with FDA's approval of substances used in production are sufficient, in most cases, to protect the health of the consumer against harmful ingredients and ensure product integrity. 48 Fed. Reg. 45,552 and 45,553. Thus, existing regulations combined with case-by-case mandatory ingredient labeling safeguard the consumer and provide useful information concerning alcohol beverages.

COSTS

In 1980 your agency estimated that the cost of compliance with this regulation ranged from 6/100ths of a cent to no more than two cents per bottle or can. Yet in 1983 you concluded that compliance costs would be substantial.

Senator Proxmire: What are your current estimates of the cost of compliance on a per bottle or per can basis? Why do they differ significantly from the earlier estimates?

Mr. Higgins: ATF made a critical re-examination of the BDM study in rescinding T.D. ATF-66, the across-the-board ingredient labeling rule. As explained in T.D. ATF-150, the BDM study had estimated that the expected costs of ingredient labeling to industry and the Government ranged from $12 million to $150 million per year, with industry start-up costs of between $18 million and $35 million. There was evidence on the 1983 record that start-up costs for the distilled spirits industry alone would be $46.4 million in 1984 dollars, with costs to the consumer totaling $21.3 million annually by 1987.

With respect to per unit costs of compliance, the BDM study stressed that its calculations with respect to wine and beer must be considered as the lower bounds since they did not take into account factors such as differences in container size or differences in cost structure throughout the industries. (Page VII-17.) ATF still concludes that the evidence on the administrative record with respect to per unit costs is uncertain. Furthermore, as explained in T.D. ATF-150, even T.D. ATF-66 concluded that the evidence on the 1980 record was not straightforward with respect to costs.

Senator Proxmire: Would you submit for the record your methodology in reaching these estimates and how that methodology differs from the 1980 calculation?

Mr. Higgins: With respect to the methodology utilized by ATF in making its findings concerning costs, T.D. ATF-150 explains that the administrative record demonstrated that the costs of ingredient labeling to the alcohol beverage industry are broad in scope requiring the redesign and production of front and back labels; equipment modification and the installation of new equipment; the design and production of new bottle molds; additional product laboratory analysis; the implementation of new administrative and record procedures; and additional labor expenses related to labeling, recordkeeping, and product handling. The costs which would be incurred by the Government as well as by the consumer are also discussed at length in T.D. ATF-150. 48 Fed. Reg. 45,551 and 45,552.

In addition, ATF relied upon many of the conclusions reached in the BDM study in making its findings. For example, the BDM study had emphasized (at page VII-26), and other evidence on the administrative record had indicated, that the cost factors involved in full ingredient labeling impact most heavily upon small businesses. Moreover, the BDM study had not examined the costs associated with the alternative address label required in T.D. ATF-66. Although T.D. ATF-66 had concluded, without analysis, that this option would reduce costs, T.D. ATF-150 explains that evidence on the record indicates that the costs associated with changing existing labels would be incurred in connection with the address label option. Thus, it is clear that ATF focused on the economic impact of the ingredient labeling rule, as evidenced on the entire rulemaking record, rather than on any one particular cost factor in reaching its conclusions on costs in T.D. ATF-150.

Lastly, it must be emphasized that T.D. ATF-150 considered the costs associated with a particular labeling requirement only as a matter of secondary importance and not as determinative of whether information should be placed on a label. 48 Fed. Reg. 45,552.

CONCLUSION

Based on the uncertainty of the health issues, the potential for consumer misinformation due to the nature of the alcohol beverage process and all other evidence contained in the record, the Bureau concluded in T.D. ATF-150 that consideration of the need to require the labeling of a specific ingredient on a case-by-case basis provides a more reasonable course and is more beneficial to the consumer than across-the-board labeling.

FEDERAL LAW ENFORCEMENT TRAINING CENTER

STATEMENT OF CHARLES F. RINKEVICH, DIRECTOR

ACCOMPANIED BY:

- DAVID D. QUEEN, ACTING ASSISTANT SECRETARY (ENFORCEMENT AND OPERATIONS) DEPARTMENT OF THE TREASURY
- DAVID W. McKINLEY, DEPUTY DIRECTOR, FEDERAL LAW ENFORCEMENT TRAINING CENTER
- WILLIAM M. KELSO, ASSISTANT DIRECTOR, ADMINISTRATION, FEDERAL LAW ENFORCEMENT TRAINING CENTER
- JOHN C. DOOHER, ASSISTANT DIRECTOR, WASHINGTON OFFICE, FEDERAL LAW ENFORCEMENT TRAINING CENTER
- JILL E. KENT, DEPUTY ASSISTANT SECRETARY FOR DEPARTMENTAL FINANCE AND PLANNING, DEPARTMENT OF THE TREASURY

PREPARED STATEMENT

Senator ABDNOR. Our final testimony today will be the presentation by the Federal Law Enforcement Training Center [FLETC].

Let me say Senator Mattingly sends his greetings. He is chairing another military construction hearing this morning. He has a few questions that I am going to submit for the record to be answered by you.

We have ourselves stretched pretty thin here. I know Senator DeConcini would like very much to be here but he is at a judiciary hearing dealing with a Federal judge. So we find ourselves a little shorthanded here.

We welcome you to the committee. You just proceed any way you want to.

You want to start off, Mr. Queen?

Mr. QUEEN. I will follow the same approach that I did with Director Simpson of the Secret Service. I will submit the remarks that were prepared and sent up to the committee earlier.

Senator ABDNOR. They will be made part of the record.

[The statement follows:]

STATEMENT OF DAVID D. QUEEN

I am pleased to appear before you in support of the annual appropriation request of the Federal Law Enforcement Training Center for fiscal year 1987. I am testifying because Assistant Secretary Keating is unable to be here today. He is traveling with the Attorney General on a factfinding mission to Thailand, Burma, India, and Pakistan, to investigate the problem of drug trafficking in and through that region.

Before I comment on the Center's activities, I would like to introduce to the committee Charles F. Rinkevich, the Director of the Federal Law Enforcement Training Center. Director Rinkevich is accompanied by several senior members of the Center's staff whom he will introduce later. Also in attendance with us is Jill Kent, the Deputy Assistant Secretary for Departmental Finance and Planning.

Mr. Chairman, as you know, the FLETC is a law enforcement bureau of which the Treasury Department is extremely proud. The Center is remarkable in its capability to provide, in a professional and cost-effective way, the law enforcement training that is critical to Federal law enforcement. At a time in our Government's history when it is especially important to be cost conscious, the Center already has a demonstrated reputation for fiscal responsibility.

The Center recently completed its first decade of operation at Glynco, and I believe it would be appropriate to reflect briefly on its development and achievements.

The Center was created as a result of a memorandum of understanding with its participating organizations, whose collective determination was to improve the training of Federal law enforcement officers throughout this Nation. The Department of the Treasury was identified as the lead agency for administering the Center's operations because of the Department's successful experience, through the Treasury Law Enforcement School, in meeting the training needs of its four enforcement bureaus. This program thus became the nucleus for the Center's concept of consolidated training, which has expanded to include nearly all Federal organizations. A Board of Directors, representing the interests of the entire law enforcement community provides policy direction.

Today, personnel from 59 Federal police and investigative agencies within all three branches of Government are trained at Glynco. This includes mandatory training for individuals entering into the Federal service and advanced training for journey level personnel in order to prepare them to meet changing mission requirements and advances in technology. The breadth of training provided and supported at Glynco encompasses the practical, everyday skills and knowledges that professional law enforcement officers need to execute effectively their statutory responsibilities. For example, training is provided in such areas as investigating sophisticated computer-related crimes, executing a legal search warrant, exercising proper judgment in firing a weapon and intercepting the illicit flow of drugs and aliens into the United States.

The Glynco facility itself is first rate. This 1,500 acre, campus-like setting is ideally suited for law enforcement training. Through consolidation of training at this site, there now is an estimated annual savings of $31 million to the American taxpayer. This has been achieved by closing several duplicative and costly training locations previously operated around the country, and by realizing savings in per diem expenses through the use of the Glynco training site.

In response to special situations that have arisen in recent years, the Center has shown a capability and willingness to accept new responsibilities. In 1982, at the request of the President, the Departments of Treasury and Justice established a National Center for State and Local Law Enforcement Training. This effort capitalizes on the unique Federal expertise and resources that exist at Glynco for development and presentation of many specialized training programs. In a relatively short period of time, this program has become a keystone in the administration's war on crime.

In 1985, the Center began conducting training at its satellite facility near Marana, AZ. Principally, this location is being used to provide fully reimbursable training for the Bureau of Indian Affairs and tribal police officers from the Southwest United States.

During the past 2 years, the Center also has assisted the Department of State, at its request, in supporting special training programs for foreign officials directed at strengthening the efforts against international terrorism. In a similar vein, the Center developed and presented Federal Air Marshal Training Program represents an excellent example of the Center's ability to quickly and competently react to sudden crisis situations.

The pending appropriation request for fiscal year 1987 is $20,899,000. This funding will permit the Center to meet certain costs for training for all of its participating clientele and to continue to maintain the $100 million investment in facilities at Glynco. With this funding level, the Center can continue to meet its primary mission responsibilities. Other training requirements will be accommodated on a reimbursable basis as in the past.

Finally, I would point out that the Treasury Department is deeply committed to maintaining the excellence of the Federal Law Enforcement Training Center and to supporting its crucial role in American law enforcement.

PREPARED STATEMENT

Mr. QUEEN. I will defer to the very capable Director of FLETC, Mr Charles Rinkevich.

Senator ABDNOR. Mr. Rinkevich, we welcome you. Your entire statement will be made a part of the record, and we will go from there.

[The statement follows:]

STATEMENT OF CHARLES F. RINKEVICH

Introduction

Mr. Chairman and Members of the Committee, I am pleased to be here today to report on the operations of the Federal Law Enforcement Training Center and to support our appropriation request for Fiscal Year 1987.

At this time, I would like to introduce the representatives of the Center who have accompanied me: William M. Kelso, Assistant Director for Administration; and John C. Dooher, Assistant Director for our Washington Office.

As you know, the Center's mission is to provide basic and advanced training for the bulk of our Nation's law enforcement personnel. We also support the training provided by our participating agencies that is specific to their individual needs. The interagency dimension of the Center provides us with diverse agency expertise and allows us to economically use this expertise to accommodate multiple agency training requirements.

Participating Organizations

Although the number of the Center's participating organizations has increased over the years from 17 to 59, in FY 1985, because of space limitations, the Center's Board of Directors deferred requests from two new Federal Agencies for participating organization status. However, these agencies will be trained on a space available basis. The mere fact that more agencies wish to avail themselves of the Center's unique ability to provide quality training attests to Glynco's reputation. By any measure, Glynco continues to be one of the Federal Government's true success stories.

Workload

During FY 1985, we trained over 16,000 students. This total included almost 15,000 students in Glynco's various Basic, Advanced, and State and local programs; over 400 students at our satellite facility at Marana, Arizona; and nearly 800 students through export programs. Despite this consistent heavy workload, the Center continues to provide quality training and still is able to respond to the unique, and sometimes emergency, needs of our agencies.

Often, requests to develop new training programs come to us under crises conditions with a short timeframe for completion. For example, because of a dramatic increase in the personnel strength of the Immigration and Naturalization Service (INS), the Center was asked to provide training for 1,000 additional Border Patrol agents in FY 1985. This request required a rapid and innovative response. With the support and cooperation of the Immigration Service and Border Patrol, the Center was able to react to this unusual demand, enhance its facilities and staff, and provide the necessary training. I am proud to say that we accommodated the entire 1,000 new Border Patrol trainees at Glynco.

Additionally, in the fall of 1985, we received a request from the Federal Aviation Administraton (FAA) to develop an Air Marshal Training Program as part of the Administration's response to terrorist skyjacking incidents. Within a few short weeks, Glynco staff, working in conjunction with representatives from FAA, developed a five-week program and began training at our Marana facility. We graduated the last of five classes of Air Marshals in December 1985.

Glynco's positive response to these unique demands are direct benefits of a consolidated training center.

Organization

In May 1985, following the recommendations of an Internal Assessment Group that I commissioned, the Center moved into a reorganization to streamline its operational and administrative functions. The transition into the reorganization has been smooth and one of our major goals now is to increase our concentration on improving training programs. To this end, the Center has recently conducted several Curriculum Conferences, calling on the expertise of personnel from our various agencies to examine our training programs and update them as needed. In addition, we have established a Research and Evaluation Unit, which has the responsibility of conducting training related research and evaluating various aspects of our programs.

Workload Statistics

Mr. Chairman, I call your attention to the table on Page 5 of my statement reflecting our workload statistics for FY 1985, along with projections for FY 1986 and FY 1987. I will not go into this chart in great detail at this point, but I will be happy to answer any questions you may have concerning these statistics.

Gramm-Rudman-Hollings Act

Like most agencies, we have yet to realize the full impact of the Gramm-Rudman-Hollings Act on the Center and its future. However, in compliance with the Act, the Center has absorbed a reduction in its FY 1986 budget in the amount of $1,024,000; and we have had early indications of cutbacks in some training by our client agencies necessitated by their budget reductions.

FEDERAL LAW ENFORCEMENT TRAINING CENTER
FUNDING AND WORKLOAD DATA
(Dollars in Thousands)

	1985		1986 1/		1987 1/	
Funding:						
Appropriated	$18,341		$17,803		$20,899	
Reimbursable	10,006		14,606		10,388	
TOTAL	$28,347		$32,409		$31,287	
Workload:	Students	Student Weeks	Students	Student Weeks	Students	Student Weeks
Criminal Investigator Basic	1,146	8,058	2,222	16,443	1,330	9,812
Police Basic	786	6,850	1,611	12,617	1,372	10,891
Police Integrated Basic	1,492	22,790	2,074	25,338	1,676	21,578
Follow-on Basic	3,443	13,095	4,442	16,110	3,217	11,862
Center Advanced	1,490	2,746	3,216	5,781	2,356	4,256
Agency Advanced	5,999	9,618	7,323	13,188	7,494	14,096
State and Local	1,766	1,950	2,094	2,589	2,118	2,637
TOTAL	16,122	65,107	22,982	92,066	19,563	75,162
Funded ARSP 2/	251		141		620 3/	
Reimbursable ARSP	1,001		1,629		825	
TOTAL	1,252		1,770		1,445	
Full Time Equivalent	264		264		269	

1/ FY 1986 and FY 1987 workload data are based on agency projections received in July 1985.

2/ ARSP - Average Resident Student Population.

3/ FY 1987 funded ARSP based on new policy of funding direct training costs only vice previous policy of funding student travel, food, lodging and direct training costs.

FY 87 Budget Request

Let me turn your attention now to the Center's FY 1987 budget request. This request reflects a fundamental change in our funding policy. In past years, the Center's appropriation included funds for student travel, meals, lodging and direct basic training costs. However, for FY 1987, we are requesting funding for direct costs only for basic training. These direct costs include such items as class and student supplies, staff and faculty services, and operation of the Glynco facility. Under this policy, participating organizations are required to reimburse the Center for all student lodging and food costs, as well as to absorb the costs of student travel to and from Glynco.

Our appropriation request for FY 1987 is $20,899,000 and we contemplate $10,388,000 in reimbursable income to the Center for a total FY 1987 budget of $31,287,000. This will allow us to train over 19,500 students in the various programs as shown on the chart on Page 5.

Maintenance of Facility

In FY 1979, Congress approved the use of $10.2 million of previously appropriated constructon funds for repairs, alterations, and minor construction at Glynco. These funds now have been depleted, except for one claim pending in GSA. The FY 1986 salaries and expenses funding includes $2.1 million in no-year funding to meet ongoing needs in this critical area.

In the budget request before you today, we are seeking an appropriation of $3 million in no-year funding to assure the continued maintenance of the facility and provide a safe environment for students and staff. The "no-year" funding is requested to provide adequate time for planning and completion of various projects.

I now would like to address several recent accomplishments of the Center which serve as background to this budget request.

National Center for State & Local Training

The National Center for State and Local Training was established by President Reagan in 1982 and provides training for State and local law enforcement agencies in over 20 selected advanced subjects. The National Center receives broad support from the Federal law enforcement community as well as our colleagues from State and local agencies, both of whom provide subject matter experts for program development and instructional services.

The National Center has been so successful that requests for training often exceed the space available at Glynco. Thus, in addition to providing an opportunity to attend training at Glynco, some of these programs are conducted on a export basis at sites across the country. The funds included in our budget request will enable us to continue to support program administration, course development, Advisory Committee and other overhead expenses. Consistent with the shared funding concept that always has been part of our National Center, State and local agencies continue to be responsible for all expenses related to salaries, travel and per diem associated with this training.

Marana Operations

In 1984, the Department of the Interior's Bureau of Indian Affairs (BIA) requested that the Center manage the Indian Police Academy. We are now conducting that training at a satellite location, the Pinal Air Park, near Marana, Arizona, approximately 25 miles north of Tucson. Because Marana is a contractor operated facility already being utilized for fire suppression training by other Federal agencies, the Center was able to negotiate an expansion of its capability to provide cost-effective law enforcement training for the BIA.

In January 1985, the Center conducted its first 10-week Basic Indian Training Program at Marana; and since that time, we have conducted several additional programs, including Advanced BIA training as well as some short-term Center and Agency Advanced training. During FY 1985, a total of 420 students graduated from the Marana facility, including 240 students from the Indian Police Academy programs and 180 students from Center and Agency Advanced programs.

Marana in no way duplicates the special training features available at Glynco, but it does serve as an adequate satellite facility to meet the training requirements of the participating organizations who have personnel posted in the Western United States.

Anti-Terrorism and Foreign Training

With the approval of Congress, the Administration initiated an Anti-terrorism Assistance Program in late 1983. This program is designed to improve the capabilities of the civil authorities in friendly foreign countries so that they may better deal with the expansion of international terrorism. Responsibility for administering the program rests with the State Department's Office for Counter-Terrorism and Emergency Planning. In February 1984, at the State Department's request, the Center agreeed to participate in this program predicated upon the availability of staff and facility resources.

The Assistance Program consists of three phases: consultation and visit to key United States facilities by senior officials from a participating country; selection or design of training programs relevant to a particular country's need; and implementation of the selected training.

During FY 1985, Glynco hosted ten foreign delegations of senior government representatives from a number of countries including Italy, Camroon, Colombia, Greece, Israel, Portgual, Tunisia, Brunei, Honduras, and Denmark. These delegations participated in two-day visits and briefings on potential areas of assistance and interagency cooperation. Center representatives also travelled to Portugal and Costa Rica to assess specific areas of needed training. Jointly with the Office of State Security, the Center also conducted two programs in explosives recognition for the East Caribbean States and a security program for senior Egyptian personnel. Additionally, the Bureau of Alcohol, Tobacco, and Firearms delivered explosives training to three groups from Egypt, Costa Rica and Columbia at Glynco.

Thus far in FY 1986, Portugal, Costa Rica, Honduras, Pakistan, Persian Gulf States and the Netherlands have received assistance from the Federal Law Enforcement Training Center, and we anticipate requests from several other countries for training during this fiscal year.

As a result of language in the FY 1986 appropriation, the Center and Treasury officials have been working on a study and plan for anti-terrorism training for all Federal law enforcement personnel who have a need for it. It is important to note that, Glynco presently offers anti-terrorism training in a number of basic programs. However, with the increased threat that we face, we believe it necessary to reevaluate that training. Primarily, this will involve recognition and familiarization training for some agencies, and first responder training for others. Our initial plans, being developed in cooperation with the Department of Justice and the FBI, will contain milestones for the identification of needs and provision of increased anti-terrorist training for those of our participating organizations for whom it would be appropriate. A series of conferences with affected agencies will be held beginning in the next few weeks to develop these plans further.

In anticipation of the Center's increased involvement in Anti-Terrorism training, I have also established a faculty committee to coordinate these conferences and assume responsibility for the identification, development, and implementation of courses and programs which will be incorporated into our on-going curricula.

Mr. Chairman, as you know from earlier correspondence with Assistant Secretary Keating, the Department and the Center believe that our existing training delivery system can be responsive in implementing anti-terrorism training and we will keep you informed of our progress.

ADP Modernization

The Center has made great strides in its ADP modernization efforts during this past year. We have appointed a full time Information Systems Officer and begun the design of a completely automated and integrated scheduling and training administration system. With the assistance of an interagency advisory committee, software is being designed and hardware specifications are being developed so that all the resources that are needed to support resident students are efficiently used. We also have made significant progress toward our objective of an automated testing and evaluation system that will eventually permit the on-line testing, scoring, and tracking of each student's academic performance. In this fiscal year, we will spend $625,000 on our ADP modernization project; equally distributed among the three categories of Equipment, Systems Analysis and Programming, and Systems Design and Engineering.

Closing

Mr. Chairman, in closing, I want you to know that I strongly support the efforts of the Administration and this Committee to control Government expenditures. At the same time, I am committed to work toward the accomplishment of the Center's mission to provide the best possible training to the men and women who enforce our Nation's laws. Substantial savings are already being realized through the operation of the Center as a consolidated training facility, and we are confident that our programs are meeting the needs of the participating organization. Our budget request reflects a concern for fiscal restraint, as well as a commitment to quality training. I appreciate the continued support and guidance of this Committee and the excellent cooperation of the many law enforcement organizations we serve.

My colleagues and I now are available to answer any questions you may have concerning this request.

INTRODUCTION OF ASSOCIATES

Mr. RINKEVICH. Thank you.

Mr. Chairman, I am pleased to be here today to report on the operations of the Federal Law Enforcement Training Center and to support our appropriation request for fiscal year 1987.

I would like to introduce the members of the Center staff who are with me today. On my immediate right is David McKinley, who is the Deputy Director of the Center

On his right is Mr. William Kelso, who is our Assistant Director for Administration; and, on the far left, is John Dooher, Assistant Director for our Washington office.

Senator ABDNOR. We certainly welcome you gentlemen to the committee. I enjoy working with you.

Mr. RINKEVICH. As you know, the Center's mission is to provide basic and advanced training for the bulk of our Nation's law enforcement personnel. We also support the training provided by our participating agencies that is specific to their individual needs. The interagency dimension of the Center provides us with diverse agency expertise and allows us to economically use this expertise to accommodate multiple agency training requirements.

PARTICIPATING ORGANIZATIONS

Although the number of the Center's participating organizations has increased over the years from 17 to 59, in fiscal year 1985, because of space limitations, the Center's Board of Directors deferred requests from two new Federal agencies for participating organization status. However, these agencies will be trained on a space available basis. The mere fact that more agencies wish to avail themselves of the Center's unique ability to provide quality training attests to Glynco's reputation. By any measure, Glynco continues to be one of the Federal Government's true success stories.

WORKLOAD

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Often, requests to develop new training programs come to us under crisis conditions with a short timeframe for completion. For example, because of a dramatic increase in the personnel strength of the Immigration and Naturalization Service, the Center was asked to provide training for 1,000 additional border patrol agents in fiscal year 1985. This request required a rapid and innovative response. With the support and cooperation of the Immigration Service and border patrol, the

Center was able to react to this unusual demand, enhance its facilities and staff, and provide the necessary training. And I am proud to say that we indeed accommodated those 1,000 border patrol trainees at Glynco.

Additionally, in the fall of 1985, we received a request from the Federal Aviation Administration [FAA] to develop an Air Marshal Training Program as part of the administration's response to terrorist skyjacking incidents. Within a few short weeks, Glynco staff, working in conjunction with representatives from FAA, developed a 5-week program and began training at our Marana facility. We graduated the last of five classes of air marshals in December 1985.

Glynco's positive response to these unique demands are direct benefits of a consolidated training center.

ORGANIZATION

In May 1985, following the recommendations of an internal assessment group that I commissioned, the Center moved into a reorganization to streamline its operational and administrative functions. The transition into the reorganization has been smooth and one of our major goals now is to increase our concentration on improving training programs. To this end, the Center has recently conducted several curriculum conferences, calling on the expertise of personnel from our various agencies to examine our training program and update them as needed. In addition, we have established a research and evaluation unit, which has the responsibility of conducting training-related research and evaluating various aspects of our training program.

WORKLOAD STATEMENT

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GRAMM-RUDMAN-HOLLINGS ACT

Like most agencies, we have yet to realize the full impact of the Gramm-Rudman-Hollings Act on the Center and its future. However, in compliance with the act, the Center has absorbed a reduction in its fiscal year 1986 budget in the amount of $1,024,000; and we have had early indications of cutbacks in some training by our client agencies necessitated by their budget reductions.

FISCAL YEAR 1987 BUDGET REQUEST

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MAINTENANCE OF FACILITY

In fiscal 1979, Congress approved the use of $10.2 million of previously appropriated construction funds for repairs, alterations, and minor construction at Glynco. These funds now have been depleted, except for one claim pending in the General Services Administration. The fiscal year 1986 salaries and expenses funding includes $2.1 million in no-year funding to meet ongoing needs in this critical area.

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MARANA OPERATIONS

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ANTITERRORISM AND FOREIGN TRAINING

With the approval of Congress, the administration initiated an Antiterrorism Assistance Program in late 1983. This program is designed to improve the capabilities of the civil authorities in friendly foreign countries so that they may better deal with the expansion of international terrorism. Responsibility for administering the program rests with the State Department's Office for Counterterrorism and Emergency Planning. In February 1984, at the State Department's request, the Center agreed to participate in this program predicated upon the availability of our staff and facility resources.

The Assistance Program consists of three phases; consultation and visit to key U.S. facilities by senior officials from a participating country; selection or design of training programs relevant to a particular country's need; and implementation of the selected training

During fiscal 1985, Glynco hosted 10 foreign delegations of senior government representatives from a number of countries, including Italy, Cameroon, Colombia, Greece, Israel, Portugal, and several others. These delegations participated in 2-day visits and briefings on potential areas of assistance and interagency cooperation. Center representatives also traveled to Portugal and Costa Rica to assess specific areas of needed training. Jointly with the Office of State Security, the Center also conducted two programs in explosives recognition for the East Caribbean States and a security program for senior Egyptian personnel. Additionally, the Bureau of Alcohol, Tobacco and Firearms delivered explosives training to three groups from Egypt, Costa Rica, and Colombia at Glynco.

Thus far in fiscal 1986, Portugal, Costa Rica, and four other States have received assistance from the Federal Law Enforcement Training Center, and we anticipate requests from several other countries for training during this fiscal year.

As a result of language in the fiscal year 1986 appropriation, the Center and Treasury officials have been working on a study and plan for antiterrorism training for all Federal law enforcement personnel who have a need for it. It is important to note that Glynco presently offers antiterrorism training in a number of our basic programs. However, with the increased threat that we face, we believe it necessary to reevaluate that training. Primarily, this will involve recognition and familiarization training for some agencies, and first responder training for others. Our initial plans, being developed in cooperation with the Department of Justice and the Federal Bureau of Investigation, will contain milestones for the identification of needs and provision of increased antiterrorist training for those of our participating organizations for whom it would be appropriate. A series of conferences with affected agencies will be held beginning in the next few weeks to develop these plans further.

In anticipation of the Center's increased involvement in antiterrorism training, I have also established a faculty committee to coordinate these conferences and to assume responsibility for the identification, development, and implementation of courses and programs which will be incorporated into our ongoing curricula.

Mr. Chairman, as you know from earlier correspondence with Assistant Secretary Keating, the Department and the Center believe that our existing training delivery system can be responsive in implementing antiterrorism training and we will keep you and the committee informed of our progress.

AUTOMATED DATA PROCESSING MODERNIZATION

The Center has made great strides in its automated data processing [ADP] modernization efforts during this past year. We have appointed a full-time information systems officer and begun the design of a completely automated and integrated scheduling and training administration system. With the assistance of an interagency advisory committee, software is being designed and hardware specifications are being developed so that all of the resources that are needed to support resident students are efficiently used. We have also made significant progress toward our objective of an automated testing and evaluation system that will eventually permit the on-line testing, scoring, and tracking of each student's academic performance. In this fiscal year, we will spend $625,000 on our ADP modernization project; equally distributed among the three categories of equipment, systems analysis and programming, and systems design and engineering.

CLOSING

Mr. Chairman, in closing, I want you to know that I strongly support the efforts of the administration and this committee to control Government expenditures. At the same time, I am committed to work toward the accomplishment of the Center's mission to provide the best possible training to the men and women who enforce our Nation's laws. Substantial savings are already being realized through the operation of the Center as a consolidated training facility, and we are confident that our programs are meeting the needs of the participating organization.

Our budget request reflects a concern for fiscal restraint, as well as a commitment to quality training.

I appreciate the continued support and guidance of this committee and the excellent cooperation of the many law enforcement organizations we serve.

We are now available to answer any questions you may have, Mr. Chairman.

GRAMM-RUDMAN-HOLLINGS IMPACT

Senator ABDNOR. Thank you, Mr. Rinkevich. We certainly know of the fine work that you and your people are doing in training law enforcement officials. It sounds like the one in Arizona is moving along nicely.

We have asked every agency to tell us how Gramm-Rudman-Hollings has hit them and again say the same to you. We would like to have for the record a more complete reporting of this to take into consideration when we work on the budget.

Just briefly, how much manpower did you lose? Were you able to absorb it all in cuts in areas other than manpower?

Mr. RINKEVICH. Yes, sir, we did not absorb, or need to absorb any cuts in our personnel expenditures. We lost no manpower as a result of Gramm-Rudman-Hollings.

Senator ABDNOR. You had to postpone some things you were going to do? Did this make you curtail buying some of the equipment? I do not suppose equipment is quite as big an item with you.

Mr. RINKEVICH. The total Gramm-Rudman-Hollings reduction for the Center, Mr. Chairman, as I indicated was a little over $1 million, $1,024,000. That reduction was applied to an appropriation in our 1986 budget that would have allowed us to build a dormitory. At the same time, in the 1987 budget that the President submitted, he asked that the balance of that dormitory account, that is after the $1,024,000 was removed, be rescinded. So our total reduction under Gramm-Rudman-Hollings was in the dormitory.

Senator ABDNOR. I see back on page 5 you referred us to, that the number of students, trainees, whatever they are, will be down in 1987 over the previous years. Is that because of Gramm-Rudman?

Mr. RINKEVICH. No, sir; the 1987 request or projections shown on that chart on page 5 did not take into account the effect of Gramm-Rudman-Hollings. Those projections are the result of the agency's projections to us before they began to apply Gramm-Rudman-Hollings. 1985 and 1986 are a little higher because of special hiring that went on; the border patrol hiring, for example, and some other special buildups that are occurring within State security and some of the other agencies. So, in 1987, absent anything that Gramm-Rudman-Hollings will do to us, it reflects a sort of leveling off of spurts of hiring by some Federal agencies during 1985 and 1986.

POTENTIAL FISCAL YEAR 1986 SPENDING LEVEL FREEZE

Senator ABDNOR. You heard us mention this morning that if they were to freeze budgets at the 1986 level, what would that do to you?

Mr. RINKEVICH. We have done a very quick computation, Mr. Chairman, based on your earlier questions, and it looks to us that if the reduction or freeze were applied in 1987, the effect would be on the amount of training that we would be able to provide. The basic training that we would be able to provide on a nonreimbursable basis, that is, the funds that we have in our budget to provide support for basic training, the direct costs in support of basic training, would be reduced from about 70 percent now to something around 25 percent. So, the reduction would be in our ability to provide the direct support for basic training for the agencies at the Center.

NEW FUNDING POLICY

Senator ABDNOR. According to your statement, the Department is proposing a new funding policy for the Center to cover the direct costs of the Basic Training Program.

It is no secret this subcommittee believes a unified budget for the Center is the answer instead of the program the Department is proposing. If one considers that agencies make a practice of observing cuts by cutting training, I am concerned for several reasons.

First, I am concerned that training is being curtailed. It is important. And, second, if agencies have to cover all costs, it will adversely impact the Center.

As a historical record, I have several questions on this that we are going to submit to you, if you do not mind, for your comment.

Does this new policy differ from the way the Center has been funded in the past?

Mr. RINKEVICH. Yes, sir; it does. In the past, the Center's budget requests had sought appropriations to cover the direct costs of basic training, and the cost of meals, lodging, and transportation to and from the Center for all basic training for our students.

The 1987 policy would have the Center's budget account for funds to pay the direct costs of basic training only, thereby expecting the agency to pay the costs of the students' food and lodging while at the Center, and all transportation costs to and from Glynco. That is the essential difference.

FUNDING CAPABILITY TO MEET BASIC TRAINING NEEDS

Senator ABDNOR. Will this new method ensure that all basic training will be accomplished for your 59 participating agencies?

Mr. RINKEVICH. It will ensure that all basic training is accomplished to the extent that they have funds in their budgets to reimburse the Center. To the extent that they have reductions because of Gramm-Rudman-Hollings or any other purpose, it will affect their ability to provide basic training.

Senator ABDNOR. Do you know if they are budgeting for that?

Mr. RINKEVICH. We have informed all of our participating agencies of the policy, so my assumption would be that each of them is requesting funds in their budget.

AMOUNT OF ADDITIONAL FUNDS NEEDED

Senator ABDNOR. How much additional funding in fiscal year 1987 would the Center need to meet all of the training costs, including travel, room and board for the agencies?

Mr. RINKEVICH. I would have to provide you that figure for the record, Mr. Chairman; but I think it will be in the area of $8 or $9 million additional.

MARANA, AZ, FACILITY

Senator ABDNOR. I guess you pretty well told us how the satellite of Marana is working out. I think it has been quite satisfactory.

Mr. RINKEVICH. Yes; we are pleased with the Marana facility, Mr. Chairman.

BIA REIMBURSEMENTS

Senator ABDNOR. Does that completely wash so far as your expenses versus what the BIA pay, I mean the amount.

Mr. RINKEVICH. BIA reimburses us for a vast majority of the costs. I do not think it is a complete wash. Mr. McKinley I think can give a more specific answer to that. But most of those costs are reimbursed directly to us by the BIA, because most of the training at Marana is conducted for BIA.

Mr. MCKINLEY. Yes; we operate on a totally reimbursable basis. We have several different devices that we use. BIA provides some basic funding in terms of paying for space and some money for personnel costs. Then they also pay a tuition cost, depending on the program they are running. Like any other agency that uses that facility, they pay the tuition costs and reimburse us for food and lodging. So the facility is totally reimbursable.

NUMBER OF STUDENTS TRAINED AT MARANA

Senator ABDNOR. You have about 450 at a time, did I hear you say?

Mr. MCKINLEY. Last year we trained 450 students. This particular fiscal year we are looking at about 1,300 students. Primarily, the core again is BIA, its basic training and advanced training. But we have done some training, for example, in the FAA's Air Marshal Program, as well as some foreign training and some in-service training for both the Customs Service and the border patrol.

TRAINEES FROM SOUTH DAKOTA

Senator ABDNOR. Do you have any people come down from South Dakota?

Mr. MCKINLEY. I am sure we do. We could let you know if there have been, but I am sure we have had some students from that area.

MARANA FACILITY

Senator ABDNOR. This is the first year. Are you prepared to grow if you have to?

Mr. RINKEVICH. Yes, sir; one of the advantages of that Marana facility, Mr. Chairman, is that it is entirely contractor operated. We have no investment in the land or the buildings. So we can expand or contract our involvement there.

Senator ABDNOR. Good.

STATE AND LOCAL TRAINING

Mr. Rinkevich, how will this budget impact the State and local training programs?

Mr. RINKEVICH. The 1987 budget request would allow us to fund the development and delivery of instructional services for the State and local programs, which we project will fit well into the Center against our daily space availability requirements. The requested funds will be an adequate amount to support that program, as we project the necessary needs to be in 1987.

The State and local programs have always been conducted under a shared-funding concent; that is, from the beginning we have asked that State and local agencies pay for their student's food and lodging while at the Center, their transportation costs to and from the Center, and the individual's salary, of course. So that funding concept will continue, and we hope to be able to underwrite the costs of actually developing and delivering the programs aside from those expenses.

TRAINING FOR THE GOVERNMENT OF THE BAHAMAS

Senator ABDNOR. OK. Foreign delegations have used training in recent years and the Drug Enforcement Administration [DEA] is spending considerable funding for antidrug operations. DEA is currently training at Quantico. My question is more or less a general one. Has there been any inquiry of the Center by the Government of the Bahamas? I touch on it because the islands are, without a doubt, the center of drug trafficking operations. Is training of Bahamian law enforcement officials a practical consideration?

Mr. RINKEVICH. I am not aware of any direct contacts with the Government of the Bahamas. I should point out, Mr. Chairman, the contacts that come to us for foreign training are invariably through our State Department. It is entirely possible that the State Department could be talking with the Government of the Bahamas and we just do not know about it. When we learn from the State Department who they would ask us to train, we make a decision as to whether we can accommodate them accordingly.

WORKLOAD REDUCTION

Senator ABDNOR. We may do a little more exploring with the State Department. Your justification indicates sizable training workload reduction in fiscal year 1987. Does this confirm what we discussed earlier?

Mr. RINKEVICH. Yes, sir; those reductions do not include the projections for 1987 and do not include any anticipated reductions as a result of Gramm-Rudman-Hollings, but just our agency's normal anticipated projections as to what training they would need for fiscal 1987.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Well, I think we will submit some additional questions to you in writing, if you do not mind, and say this concludes our questions for now. We certainly thank you folks for being with us today. We have had a long session.

Mr. RINKEVICH. Thank you.

Senator ABDNOR. Thank you for coming.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Additional Committee Questions

GRAMM-RUDMAN-HOLLINGS REDUCTIONS

SENATOR ABDNOR. Gramm-Rudman-Hollings reductions have affected all agencies. Many agencies have testified that they have reduced training and travel as a way to make the cuts. Are you seeing that in the number of students coming to Glynco?

MR. RINKEVICH. It is too early to predict what the total impact on training will be, but we have experienced some cancellations of training due to the Gramm-Rudman-Hollings Act. To date, 10 basic classes involving 328 students and 31 advanced classes involving 738 students have been cancelled by the Participating Organizations.

MINOR CONSTRUCTION AND MAINTENANCE

SENATOR ABDNOR. The Center is seeking no year funding for maintenance. I have no problem with that, but would ask that the Committee be kept apprised of expenditures.

MR. RINKEVICH. I most certainly will keep the Committee informed of our expenditures in the maintenance area. As you know, we were appropriated $2.1 million for Minor Construction and Maintenance in both FY 1985 and 1986. These funds are expected to be fully obligated by the end of FY 1986. In FY 1987, we are requesting $3 million for the Minor Construction and Maintenance program. The Center has over 150 buildings containing approximately 1.5 million square feet and is located on 1,500 acres. Many of the buildings are unique training facilities. The General Services Administration is not responsible for the maintenance of the Center facilities. These funds are used to protect the Government's investment of over $100 million in Glynco, to maintain the facilities in a reasonable condition and to enable us to meet our changing training requirements.

DORMITORY RESCISSION

SENATOR ABDNOR. In the FY 1986 Continuing Resolution for Treasury appropriations, the Congress provided $6 million for the construction of a new dormitory. The FY 1987 pending Budget contains a rescission of just under $5 million dollars for the dormitory. What happened to the other $1 million that was in the Continuing Resolution for the dormitory?

MR. RINKEVICH. The Continuing Resolution did provide $6 million for the construction of a dormitory. The Gramm-Rudman-Hollings Act cut of 4.3% reduced the available dormitory funding by $258 thousand to $5,742 thousand. The 4.3% cut in the remaining Salaries and Expenses account funding level of $17,803 thousand was $766 thousand. At the direction of OMB, the $766 thousand was reprogrammed from the dormitory program into the Salaries and Expenses Program in order to provide for funding of basic training requirements. The result of the reprogramming is that the full impact of Gramm-Rudman-Hollings is applied against the dormitory program.

SENATOR ABDNOR. If the rescission is not approved by the Congress, how will the Center make up the shortfall of about $1 million in order to build the dormitory?

MR. RINKEVICH. We would then reprogram the shortfall from the Law Enforcement Training activity, back to the dormitory construction program.

UNIFORM ALLOWANCE

SENATOR ABDNOR. I believe the uniform allowance is currently $125. How long have we been at that level? Is it adequate?

MR. RINKEVICH. You are correct, the allowance is $125 and has been at that level since 1966. That level is not adequate. A $300 allowance for new employees with a $125 allowance per year for maintenance and replacement would be adequate for the current FLETC uniform program requirements. The Continuing Resolution for FY 1986 allows us to purchase uniforms without regard to the purchase price limitation. We expect to make allowances of $300 per person during FY 1986. In the future we would need authority to exceed the $125 price limitation for new employees only.

GRAMM-RUDMAN-HOLLINGS ADJUSTMENT

SENATOR ABDNOR. Your request for FY 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen?

MR. RINKEVICH. The total Gramm-Rudman-Hollings reduction for the Center was $1,024 thousand. If the budget were increased by that in FY 1987, then we would be able to fund more Basic training. Under the new funding policy for the Center, we can fund only approximately 70% of the direct costs of Basic training. If the $1 million adjustment was made, then we could fund approximately 92% of the direct cost of Basic training, an increase of 22% or 1,540 students and 10,660 student weeks.

SENATOR ABDNOR. Would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in FY 1987?

MR. RINKEVICH. If we live with the FY 1986 reduction, we could in fact utilize that level as a base in FY 1987. The impact would have to be absorbed as a reduction in funding for the direct costs of Basic training at a time when our goal is to fund 100% of this activity.

NEW FUNDING POLICY

SENATOR ABDNOR. Would you explain the change in the funding policy for the Center?

MR. RINKEVICH. Prior to FY 1987, the policy had been for the Center to pay for all basic training costs, including the student travel, meals, lodging, and course costs to the extent funds were available. Beginning in FY 1987, under the new policy, the Center would fund 100% of the direct costs of Basic training. The participating organizations will assume responsibility for their respective student costs of travel, meals and lodging. The Center funded direct training costs, include items such as instructor salaries, benefits and personnel related costs, utilities, printing, services, materials, supplies, and equipment.

SENATOR ABDNOR. What would be the cost to the Center of providing funding not only for the direct training costs, but also the cost of travel, food and lodging?

MR. RINKEVICH. To provide funding at 100% of the Participating Organizations projections would require an additional $8,642 thousand. The breakdown would be: $1,359 thousand for direct training costs, $3,175 thousand for student travel, $2,426 thousand for food and $1,682 thousand for lodging.

OFFICE SPACE

SENATOR ABDNOR. Have you reached the 135 square foot goal? If not, why and what is your target date?

MR. RINKEVICH. The Center has not reached the 135 square feet per person office utilization rate goal. Our projected utilization rate for FY 1986 is 147 square feet per person. We have not reached the goal because of our unique facilities and the mission of the Center.

The former Glynco Naval Air Station was selected as the permanent location for the Center, and in 1975 the training operations were transferred from their temporary facilities in downtown Washington to the 1500-acre site on the southeastern coast of Georgia. Utilization of existing Navy facilities, with minimum modification, was one of the major reasons for selecting this site. Compliance with current space utilization criteria would be difficult without expensive modifications to the structures and associated mechanical and electrical systems.

In addition to the increasing training workload, the number of on-Center participating organization personnel has continued to increase significantly. Several agencies have closed training centers throughout the country and consolidated their activities at the Center. All of these programs require work space for administrators and instructors, storage space for training materials and training aids, and support facilities for the students.

With current budget constraints, we anticipate reaching the 135 square feet per person goal in FY 1990.

MARANA TRAINING

SENATOR ABDNOR. Could you provide me with data concerning the number of students from South Dakota that have been trained at the Marana facility.

MR. RINKEVICH. A total of 17 students from South Dakota were trained at Marana during FY 1985. Of this total, 16 students attended Bureau of Indian Affairs programs and 1 student attended a non-BIA advanced program. In addition, during FY 1985 we trained 46 South Dakota students in Federal programs and 21 in State and local programs at Glynco.

Questions Submitted by Senator Mack Mattingly

PARTICIPATING ORGANIZATIONS STATUS

SENATOR MATTINGLY. You mentioned that, due to space limitations, requests from two Federal agencies for training were deferred. Could you please give us a status on that situation?

MR. RINKEVICH. In February 1985, the Center received a request from the Defense Logistics Agency's Office of Command Security for participating organization status. A similar request was received from the Office of Inspector General, Administrative Office of the U.S. Courts in April 1985. When a Federal agency is accorded participating status, it is assured of a priority equal with other participating agencies in the scheduling of its personnel to attend training programs at Glynco. In acting on the requests, the Center's Board of Directors decided to defer approval of participatory status because of the consistently heavy training workload and limited housing accommodations available at Glynco. Both agencies, however, are entitled to have their personnel trained at Glynco on a space available, reimbursable basis. As circumstances permit in the future, these agencies will be considered for full participation.

DRUG ENFORCEMENT ADMINISTRATION TRANSFER

SENATOR MATTINGLY. Could you please give the Subcommittee a status on the transfer of training for Drug Enforcement Administration agents from Glynco to Quantico, Virginia? Where does that stand and how is it progressing? How has it affected Glynco?

MR. RINKEVICH. All of the DEA's basic training and the majority of its agency advanced training relocated to Quantico, VA during the latter part of FY 1985. At the present time, DEA is conducting International training and some computer training at Glynco. Both of these are scheduled to be transferred by the end of FY 1986. DEA has expressed the desire to continue participation in Center conducted Advanced programs and also would like to continue selected International training at the Center in future years. In effect, the DEA transfer has had very little impact on the workload of the Center. When the Attorney General announced that DEA training would be moving, he also announced increased participation by other Department of Justice bureaus. Since our projections are greater than the actual training capacity, the void in the training schedule that was created when DEA transferred has been filled by other agencies.

AIR MARSHALS TRAINING

SENATOR MATTINGLY. You mentioned the successful completion of five classes of Air Marshals, a new program developed as part of the Administration's response to terrorist sky jackings. Is this program completed, or do you anticipate more Air Marshal classes this year?

MR. RINKEVICH. We have completed five classes and graduated 115 students from the Air Marshals program. We do anticipate conducting one more class for 24 students later this year. Also, we plan to conduct 5 one-week classes involving 120 students in an Advanced training program.

STATE AND LOCAL TRAINING

SENATOR MATTINGLY. I am interested in FLETC's National Center for State and Local training. I believe it is so important to assist those who enforce the law on the local level. Could you go into a little more detail about that program, such as how many students you anticipate in this program this year, how many communities will be involved, what the shared funding concept is, and so on?

MR. RINKEVICH. During FY 1987, it is projected that approximately 2,100 State and local students will be trained by the Federal Law Enforcement Training Center. Twenty-five different programs varying in length from 3 days to 3 weeks will be offered to State and local students. The accommodation of the 2,100 students in the various programs represents approximately 2,650 student weeks of training.

Since the inception of the program, State and local students from every State and territory of the United States have participated in the training programs. In all, approximately 5,000 have been trained. Of this total, 75% have been representative of local agencies and 25% of State agencies. It is anticipated that these statistics will reflect about the same distribution in FY 1987.

The expenses for program development, materials, and delivery are the responsibility of FLETC; students' salaries, travel, lodging and per diem are the responsibility of the State and local agencies. This shared funding concept is utilized as long as funds are available. When the demand of State and local agencies exceed FLETC's funding capability, programs are offered on a fully reimbursable basis -- total cost of the program materials and delivery are charged as tuition.

The mission of the Center is to provide training opportunities for State and local agencies which are not otherwise readily available and which lead to enhanced interagency communication, cooperation, and general networking. An Advisory Committee representing a good cross-section of Federal, State, and local law enforcement from both an operational and training perspective assists the Center with the identification of appropriate subject areas to which resources are committed. The experience thus far has demonstrated that most all classes fill well in advance of the scheduled delivery dates; waiting lists exist for many programs because the demand exceeds the Center's capacity to accommodate.

SUBCOMMITTEE RECESS

Senator ABDNOR. I want to thank all of our witnesses not only for their testimony, but for their dedication to this country. You perform an important task and do an outstanding job. When I say outstanding job, I mean that very sincerely.

If there is no further business to come before this subcommittee, the subcommittee will stand in recess until March 27 when we will review the budget request of the U.S. Customs Service.

[Whereupon, at 11:45 a.m., Thursday, March 20, the subcommittee was recessed, to reconvene at 10 a.m., Thursday, March 27.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

THURSDAY, MARCH 27, 1986

U.S. Senate,
Subcommittee of the Committee on Appropriations,
Washington, DC.

The subcommittee met at 10 a.m., in room SD-124, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, and DeConcini.

DEPARTMENT OF THE TREASURY

U.S. Customs Service

STATEMENT OF WILLIAM VON RAAB, COMMISSIONER OF CUSTOMS

ACCOMPANIED BY:

- **DAVID D. QUEEN, DEPUTY ASSISTANT SECRETARY FOR ENFORCEMENT**
- **JILL E. KENT, DEPUTY ASSISTANT SECRETARY FOR DEPARTMENT FINANCE AND PLANNING**
- **ALFRED R. DE ANGELUS, DEPUTY COMMISSIONER**
- **WILLIAM ROSENBLATT, ASSISTANT COMMISSIONER**
- **D. LYNN GORDON, ACTING COMPTROLLER**

OPENING REMARKS

Senator Abdnor. The subcommittee will come to order and today we will continue our review of the fiscal year 1987 budget, and review testimony pertaining to the U.S. Customs Service.

Our witness will be Mr. David Queen, Deputy Assistant Secretary for Enforcement and Mr. William von Raab, the Commissioner of Customs.

I could very well have a long opening statement expressing my concerns about the budget submitted to the Congress and its impact on the Nation. However, I thought about it and I decided it would probably be a waste of time as far as me talking to you people, and I mean that in the way you obviously think your budget is adequate, which I guess you can tell I do not. So I am not going to take the time to give an opening statement like I have over the past 5 years regarding the Customs Service. Certainly, everyone knows where I stand.

Senator Mattingly is with us, and I welcome you to the opening of the committee.

Senator MATTINGLY. Thank you, Mr. Chairman.

Senator ABDNOR. I am sure you must have a statement.

Senator MATTINGLY. No; I do not. However, I do have some questions for our guests today, but I will wait until they make their short statements.

Senator ABDNOR. Then we will proceed. Before we do, I want to say one thing. I am almost at a loss for words because I feel that for the past 5 years my words have fallen on deaf ears. We seem to be playing games every year. We come in with a budget we think is totally inadequate for the responsibilities that we expect of the Customs, and instead of the responsibility of this agency becoming less, and even though we are striving for greater efficiency and all, the responsibilities are getting greater and greater.

It just seems impossible for me to understand how we can expect to do far more as I anticipate is required of us in the years ahead, to do it with less and less people. Now maybe you have some major answers. That is what we are here to listen to.

But I get a little bit tired of playing the game because I honestly believe—I think just once we really ought to let you people go out and operate under the budget you want to operate under. I think it would be darn interesting to see what would happen because I know with more manpower and with better equipment you are getting good results. You will never convince me that that could happen otherwise.

I look at the amount of confiscated drugs you are picking up each year, and all the other areas of inspection you have to do. It is just not catching drugs. It is all these other things. People say we are going to use users fees. We are going to make people pay for this service. Fine. But I think they are going to be entitled to better services, and how are they going to get better service with way less people before we get the proper equipment in place. You maintain we can do it with better equipment. Fine. But you are not going to have that in place by the time all these big cuts are taken.

I know this bothers me the most, Mr. von Raab, as I look over at the FBI and DEA and those groups that have way more dollars, and I think it is a lousy time to try to run down drugs after they get across the border and get into this country. If you can prove to me, we can do more with less I guess I will accept it. But I have to be shown. So maybe that is enough for an opening statement. But I just do not like to have us look like we are big spenders everytime we try to keep Customs in a position where they can be effective like we know you are, and can be, and will be if we provide you with the proper manpower and dollars.

I am sorry, ladies and gentlemen, we will be right back.

Senator MATTINGLY. We are going to go vote.

[A brief recess was taken.]

Senator ABDNOR. I am returning back to Senator Mattingly now.

Senator MATTINGLY. I am still not going to make a statement. I have another hearing I have to go to, but I have several questions that I would like for you to address in reference to the customs agents that you have at airports, specifically at the Atlanta Airport.

What impact has that had on the people coming back, such as tourists? We have two different conflicting opinions on that, and I figured you would probably be able to clarify that. I also gave some questions in reference to trade, the imports coming in, and whether you should be pursuing this $250 limit, and also, in reference to drugs.

One question that I did not put in in my written questions that I would like for you to address, though, is one we had discussed at an earlier time. Would it be beneficial for your agency to encourage the Defense Department to look into using the National Guard in respect to Arizona, California, and Texas—to possibly run exercises along the borders, and to assist you in some type of border patrol type activity?

Would there be any way that that could be utilized—you would probably go around the posse commitatus regulation. Maybe a recommendation coming forth from the Government to the States as to the utilization of the Guard forces in those areas would be helpful.

With that, Mr. Chairman, I am sorry I have to go to another hearing. It is always very exciting to listen to you testify, Mr. von Raab. Thank you very much, Mr. Chairman.

Senator ABDNOR. Thank you. Sorry that you have to leave. I am sure they will answer your questions.

Senator ABDNOR. Mr. Queen, I understand you have a statement as to the position of the Department, and that the Commissioner will follow. You may proceed.

Mr. QUEEN. Mr. Chairman, I like to think I can take a hint. In that vein, I will be glad to submit my statement and exercise the privilege of introducing a gentleman you obviously know well.

Senator ABDNOR. Let me assure you, Mr. Queen, I do not mean to shut you off. I probably did not give you the best setting for a statement from the Department, but go right ahead.

Mr. QUEEN. No; I will be quite glad to submit. You have been provided copies of my statement so I will leave it to the Commissioner.

PREPARED STATEMENT

Senator ABDNOR. Fine, your statement will be made a part of the record.

[The statement follows:]

STATEMENT OF DAVID D. QUEEN

I am pleased to appear before you today in support of the annual appropriations request of the U.S. Customs Service for fiscal year 1987. I am testifying because Assistant Secretary Keating is unable to be here today. He is traveling with the Attorney General on a factfinding mission to Thailand, Burma, India and Pakistan, to investigate the problem of drug trafficking in and through that region.

Appearing with me today are William von Raab, Commissioner of Customs, key staff members of the U.S. Customs Service, and Jill E. Kent, Deputy Assistant Secretary for Departmental Finance and Planning.

The budget request for the U.S. Customs Service is 693,000,000 dollars for salaries and expenses, and 54,700,000 dollars for operations and maintenance of the air program. The fiscal year 1987 budget request for the U.S. Customs Service reflects the President's policies to control government spending.

The requested funds are necessary to carry out the many missions of the U.S. Customs Service. As you know, Mr. Chairman, Customs is a law enforcement agency with a critical role in enforcing our laws against the importation of narcotics, in the investigation of currency violations, in combatting commercial fraud and other trade violations, and in stemming the illegal exportation of critical technology. It is also responsible for administering this nation's complex tariff laws, including the collection of duties, the processing of international passenger traffic, and the overall facilitation of vast quantities of imported merchandise. In fiscal year 1985, the U.S. Customs Service processed 290 million passengers and 6.8 million formal entries and collected $13.2 billion in revenue.

In its efforts to use its resources wisely, Customs continues to search for methods and procedures that will enable them to focus their greatest efforts on the "high-risk" passengers and cargo. The Treasury Enforcement Communication System (TECS) and the Automated Commercial System (ACS) are two systems that Customs has developed to achieve this goal. These systems, when fully operational, will greatly assist Customs personnel in identifying the "high-risk" passengers and cargo that require close inspection. The Automated Commercial System also will provide benefits in faster entry processing, faster cargo release, and reduction in paperwork. This budget request seeks additional funds to enhance these systems.

The U.S. Customs Service made significant advances in its law enforcement program during fiscal year 1985.

The Customs air and marine drug interdiction program made a substantial contributions to overall Federal drug enforcement. This program seized more than 50,000 pounds of cocaine last fiscal year, an 83% increase over fiscal year 1984, and established a significant deterrent along the South Florida coastline. Aircraft currently operated by Customs in its interdiction efforts include high speed jet interceptors equipped with radar and infrared detector sensors, long range trackers, high performance helicopters, single and multi-engine support aircraft, and P-3A airborne detection platforms.

Customs also contributed to our country's fight against drugs and drug-related crime through its participation in the President's Organized Crime Drug Enforcement Task Forces. Customs has played a key role in the task forces since their establishment in fiscal year 1983. In fiscal year 1985, cases involving Customs participation resulted in 909 indictments, 547 arrests, 405 convictions, and 34 million dollars in U.S. currency and property seizures. In its Task Force work, Customs, along with IRS, investigates the financial underpinnings of drug trafficking organizations and other criminal enterprises.

Customs continues to emphasize Operation Tripwire, its program to combat all types of commercial fraud. This effort concentrates on quota violations in connection with steel and textile imports, trademark and copyright violations, and other violations of our country's trade laws. In fiscal year 1985, Operation Tripwire produced 54 arrests and 230 indictments. Seizures had a total value of 67.8 million dollars.

Under Operation Exodus, Treasury combats the illegal transfer of technology critical to Eastern-bloc countries as well as illegal arms exportations. Now in its fifth year, this program continues as a key component in our country's efforts to avoid the loss of our defense-related technological secrets. In fiscal year 1985, Exodus teams made 700 seizures valued at 75 million dollars.

In summary, Mr. Chairman, the U.S. Customs Service has made substantial strides in support of critical enforcement missions of our government. It has also made progress in streamlining and improving its important commercial and passenger processing functions.

This concludes my opening statement. I will now ask the Commissioner of Customs, Mr. William von Raab, to provide you with his prepared statement, and we will then be pleased to respond to questions you or other members of the committee may have.

PREPARED STATEMENT

Mr. VON RAAB. Thank you, Mr. Chairman. It is always a pleasure and a privilege to appear before you and your committee. I have a rather extensive statement that I would ask be printed in the record.

Senator ABDNOR. It shall be made a part of the record.

[The statement follows:]

STATEMENT OF WILLIAM VON RAAB

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, WE APPRECIATE THIS OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO PRESENT THE U.S. CUSTOMS SERVICE FY 1987 APPROPRIATION REQUEST OF $693,000,000 AND 12,494 DIRECT AVERAGE POSITIONS FOR SALARIES AND EXPENSES AND $54,700,000 FOR OPERATIONS AND MAINTENANCE OF THE AIR PROGRAM. CUSTOMS ALSO IS REQUESTING AN APPROPRIATION OF $8,000,000 FOR THE FORFEITURE FUND AND $365,000 TO RECOVER ANTICIPATED REIMBURSEMENTS FOR SERVICES AT SMALL AIRPORTS.

CUSTOMS SALARIES AND EXPENSES FY 1987 APPROPRIATION REQUEST REPRESENTS A NET INCREASE OF $11,000,000 FROM FUNDS CURRENTLY REQUESTED IN FY 1986. INCLUDED IN THE FY 1987 S&E AUTHORIZATION REQUEST ARE $11,000,000 FOR ONGOING AUTOMATION AND ENFORCEMENT COMMUNICATION PROGRAMS; $24,792,000 FOR INCREASES NECESSARY TO MAINTAIN CURRENT OPERATING LEVELS; MANAGEMENT SAVINGS AND NON-RECURRING EXPENSES OF $15,127,000; AND SAVINGS OF $9,665,000 ACHIEVED BY IMPLEMENTATION OF A SELECTIVE HIRING POLICY.

CUSTOMS AIR PROGRAM OPERATIONS AND MAINTENANCE APPROPRIATION REQUEST OF $54,700,000 FOR FY 1987 REPRESENTS AN INCREASE OF $2,200,000 FROM FUNDS REQUESTED IN FY 1986 FOR MAINTAINING CURRENT LEVELS OF OPERATIONS.

THIS BUDGET REQUEST ALSO INCLUDES PROPOSED ADJUSTMENTS TO THE FY 1986 CONTINUING RESOLUTION LEVEL APPROVED BY CONGRESS. THE SALARIES AND EXPENSES APPROPRIATION INCLUDES A REDUCTION OF $30,831,000 AND 777 AVERAGE POSITIONS AS REQUIRED BY GRAMM-RUDMAN-HOLLINGS LEGISLATION AS WELL AS A PROPOSED RESCISSION OF $4,169,000. THE AIR PROGRAM OPERATIONS AND MAINTENANCE FY 1986 APPROPRIATION INCLUDES A REDUCTION OF $3,225,000 PURSUANT TO GRAMM-RUDMAN-HOLLINGS AND A PROPOSED RESCISSION OF $19,275,000.

CUSTOMS POLICY IN IMPLEMENTING THESE REDUCTIONS IS TO MINIMIZE ANY IMPACT UPON THE OPERATIONAL AND ENFORCEMENT

CAPABILITIES OF CUSTOMS FIELD UNITS. WHEREVER POSSIBLE, THE CUTBACKS ARE BEING IMPOSED SO THAT REVENUE COLLECTIONS, PASSENGER, VEHICLE, AND CARGO PROCESSING ARE NOT SIGNIFICANTLY AFFECTED. ON THE ENFORCEMENT SIDE, CUSTOMS AIR, MARINE, AND INVESTIGATIVE PROGRAMS ARE TO REMAIN FULLY STAFFED AND INVESTIGATIVE CASEWORK WILL BE FUNDED AT ITS PREVIOUS LEVELS. ON THE WHOLE, WE BELIEVE THESE GOALS ARE BEING ACHIEVED.

AT THE OUTSET, I WISH TO ALLAY THE CONCERNS MANY OF YOU HAVE EXPRESSED ON THE IMPACT OF GRAMM-RUDMAN AND OTHER REDUCTIONS PROPOSED FOR CUSTOMS IN FY 1986 AND FY 1987. FRANKLY, THE BUDGET LEVELS FOR S&E AND THE AIR PROGRAM DO NOT PERMIT US TO DO EVERYTHING WE MIGHT WISH TO DO DURING THESE YEARS. OUR SITUATION, HOWEVER, IS PROBABLY VERY SIMILAR TO MANY OTHER AGENCIES. THE CURRENT BUDGET DEFICIT MEANS THAT EACH OF US MUST DO OUR SHARE AND WE ARE WILLING AND ABLE TO DO OURS.

THEREFORE, YOU WILL NOTE THAT BOTH OUR FY 1986 AND FY 1987 PROPOSED BUDGET LEVELS REQUIRE SOME "HARD" CHOICES. IN THESE, AS WELL AS FUTURE YEARS, THERE WILL NOT BE SUFFICIENT FUNDS TO ACHIEVE ALL OF THE GOALS RELATED TO CONTROLLING DRUG SMUGGLING OR PROCESSING OF CARGO, PERSONS, AND VEHICLES. UNDER THESE CIRCUMSTANCES, IT IS IMPERATIVE THAT CUSTOMS BEGIN TAILORING ITS OPERATIONAL RESPONSIBILITIES TO ITS PROJECTED RESOURCES. DURING THIS TRANSITION PERIOD, THERE MAY BE SOME DISLOCATION, BUT WE FIRMLY BELIEVE THAT OUR PROPOSALS WILL NOT PRODUCE ANY SERIOUS INCONVENIENCE FOR IMPORTERS OR TRAVELERS AND WILL PERMIT US TO RETAIN A STRONG INTERDICTION EFFORT AT OUR LAND, SEA, AND AIR BORDERS.

MAJOR ACCOMPLISHMENTS

THE CUSTOMS SERVICE, ONCE THE MAIN SOURCE OF FEDERAL MONIES, STILL CONTINUES TODAY TO COLLECT SIGNIFICANT REVENUES AS WELL AS TO ASSUME THE RESPONSIBILITY FOR INTERDICTING DRUGS AND OTHER CONTRABAND ATTEMPTING TO ILLEGALLY ENTER THE COUNTRY. ALTHOUGH THE PRIMARY OBJECTIVE OF THE TARIFF ACT IS THE PROTECTION OF

AMERICAN INDUSTRY, REVENUE COLLECTIONS FROM ITS ENFORCEMENT PRODUCED $13.2 BILLION IN FY 1985, AND IS PROJECTED TO REACH $15.1 BILLION IN FY 1987.

AS USUAL, CUSTOMS ALSO HAD A BUSY YEAR PROCESSING A HEAVY VOLUME OF TRAFFIC AND TRADE GENERATED BY A GROWING INTERNATIONAL ECONOMY. THE CUSTOMS WORKFORCE CLEARED SOME 290 MILLION PERSONS, 6.9 MILLION MERCHANDISE ENTRIES AND MORE THAN $335 BILLION IN CARGO ENTERING THE COUNTRY. IN ADDITION, ABOUT 90 MILLION VEHICLES, VESSELS, AND AIRCRAFT WERE PROCESSED. PROJECTIONS FOR FY 1987 INDICATE CONTINUED GROWTH AND A HEAVY WORKLOAD IN THE FUTURE.

MANAGEMENT EFFICIENCIES CUSTOMS IMPLEMENTED IN PREVIOUS YEARS INCLUDE IMPROVED ADMINISTRATIVE, COMMERCIAL AND ENFORCEMENT ACTIVITIES. THESE PROGRAMS HAVE ENHANCED PRODUCTIVITY, STREAMLINED PROGRAM OPERATIONS, AND INTRODUCED SIGNIFICANT ORGANIZATIONAL AND FUNCTIONAL EFFICIENCIES. MANY OF THE EFFICIENCIES RESULT FROM CONVERTING LABOR INTENSIVE FUNCTIONS TO MORE AUTOMATED PROCESSING.

AS I STATED ON PREVIOUS OCCASIONS, CUSTOMS WILL ADHERE TO PRESIDENT REAGAN'S PRECEPTS OF STRENGTHENED LAW ENFORCEMENT AND BETTER MANAGEMENT OF GOVERNMENT RESOURCES. OUR FY 1987 OBJECTIVES WILL BE DIRECTED TO ACHIEVING THE FOLLOWING:

- IMPROVE ENFORCEMENT AGAINST THOSE ILLEGAL ACTIVITIES THAT FALL WITHIN CUSTOMS JURISDICTION BY THE INTRODUCTION OF THE MOST EFFECTIVE TECHNIQUES;

- INCREASE STAFF PRODUCTIVITY BY DEVELOPING AND IMPLEMENTING AUTOMATED SYSTEMS, WHEREVER POSSIBLE, IN ALL MERCHANDISE, REVENUE COLLECTION, AND ENFORCEMENT PROCESSING; AND,

- UPGRADE OPERATIONS BY CONSOLIDATING FUNCTIONS, ELIMINATING DUPLICATIVE ACTIVITIES, UNNEEDED PAPERWORK AND FORMS, AND SIMPLIFYING PROCESSING PROCEDURES.

CUSTOMS EFFORTS DIRECTED TOWARD STRENGTHENING LAW ENFORCEMENT PROGRAMS PRODUCED SIGNIFICANT RESULTS IN FY 1985. HOWEVER, SMUGGLING CONTINUES AS A SIGNIFICANT NATIONAL PROBLEM. WE ARE STILL CONFRONTED WITH AN ILLEGAL INDUSTRY OF BILLIONS OF DOLLARS AND CONTINUAL SMUGGLING ALONG ALL OUR BORDERS.

BUT I DO HAVE GOOD NEWS TO REPORT. CUSTOMS HEROIN AND COCAINE INTERCEPTIONS HAVE SET NEW RECORDS. HEROIN SEIZURES IN FY 1985 REACHED 785 POUNDS, UP 18 PERCENT FROM THE PREVIOUS YEARS. THE RESULTS LARGELY REFLECT INTENSIFIED INSPECTIONS AT AIRPORTS, ESPECIALLY CARGO, AND THE USE OF IMPROVED INSPECTIONAL TECHNIQUES.

WITH REGARD TO COCAINE, I MUST COMMEND CUSTOMS ENFORCEMENT GROUPS FOR THE OUTSTANDING RESULTS PRODUCED DURING THE PAST FIVE YEARS. IN FY 1981, WE SEIZED 3,741 POUNDS OF COCAINE. IN FY 1985, SEIZURES WERE SIGNIFICANTLY HIGHER, REACHING 50,506 POUNDS, FOR AN INCREASE OF 83.5 PERCENT ABOVE THE PREVIOUS YEAR AND A 13 FOLD INCREASE ABOVE FY 1981. IN TERMS OF DISRUPTION OF ORGANIZED SMUGGLING GROUPS, IN FY 1985 ABOUT $13.8 BILLION IN COCAINE SALES WERE TAKEN OFF THE STREETS AND THESE CRIMINALS WERE PREVENTED FROM POCKETING THE PROFITS.

THESE RESULTS, OF COURSE, LARGELY REFLECT THE HIGH PRIORITY OF CUSTOMS LAW ENFORCEMENT. THE NATION FACES TWO MAJOR PROBLEMS AT ITS BORDERS. THE FIRST IS MASSIVE DRUG SMUGGLING, WHICH HAS BEEN WITH US FOR AT LEAST A GENERATION AND IS NOW ONE OF OUR MAJOR INDUSTRIES. CUSTOMS HAS RESPONDED BY CONTINUING ITS SUCCESSFUL ENFORCEMENT EFFORTS IN SOUTH FLORIDA, ALONG THE SOUTHWEST BORDER, AND AT MAJOR AIRPORTS, WHERE THE MAJORITY OF ILLEGAL NARCOTICS ACTIVITY IS CENTERED. IN SOUTH FLORIDA, LARGE SUMS OF DRUG-RELATED CURRENCY ENTER AND LEAVE THE COUNTRY DAILY TO FINANCE THIS DEADLY INTERNATIONAL TRAFFIC.

ANOTHER ENFORCEMENT PROBLEM IS CRITICAL TECHNOLOGY ILLEGALLY LEAVING THE COUNTRY. IN LINE WITH PRESIDENT REAGAN'S CALL TO BLOCK THE ILLEGAL TRANSFER OF HIGH-TECHNOLOGY TO EASTERN-BLOC

COUNTRIES, CUSTOMS IS CONTINUING OPERATION EXODUS. FURTHERMORE, WE HAVE IMPLEMENTED MORE EFFECTIVE DETECTION AND INVESTIGATIVE EFFORTS AT MAJOR PORTS THROUGHOUT THE COUNTRY. TO ACHIEVE THIS GOAL, CUSTOMS HAS DEVELOPED NEW APPROACHES FOR SURVEILLANCES; IMPROVED CARGO INSPECTIONS DIRECTED AT UNCOVERING THESE ILLEGAL EQUIPMENT SHIPMENTS; AND, IMPROVED INTELLIGENCE AND INVESTIGATIVE EFFORTS RELATED TO SHIPMENTS AND POTENTIAL VIOLATORS.

WHILE THE ENFORCEMENT EFFORT IS NOW WELL ON ITS WAY TO ACHIEVING ITS OBJECTIVES, CUSTOMS SERVICE GOALS ALSO INCLUDE EFFICIENT CARGO AND PASSENGER PROCESSING. UNDER OUR CURRENT PROCESSING APPROACH, WE DO NOT BELIEVE THAT EVERY PASSENGER, VEHICLE, PIECE OF BAGGAGE, OR CARGO SHIPMENT MUST BE SEARCHED. SINCE THE VAST MAJORITY OF CUSTOMS TRANSACTIONS INVOLVE LAW-ABIDING PERSONS AND FIRMS, CUSTOMS OFFICERS ARE DIRECTING THEIR PRIMARY ATTENTION TO "HIGH-RISK" PASSENGERS AND CARGO. IT IS CLEAR TO ME THAT EFFECTIVE ENFORCEMENT AND EFFICIENT FACILITATION CAN GO HAND-IN-HAND, WITHOUT CONTRADICTION OR WITHOUT DIMINISHING OUR LAW ENFORCEMENT.

CUSTOMS ALSO IS CONTINUING ITS PRIORITY PROGRAM TO REFORM COMMERCIAL PRACTICES --IN ESSENCE, HOW WE IMPLEMENT THE TARIFF LAWS AND HOW WE PROCESS THE VAST QUANTITY OF IMPORTED MERCHANDISE. IN MEETING OUR GOALS IN COMMERCIAL PROCESSING, WE ARE PUSHING FORWARD WITH CONSOLIDATION, AUTOMATION AND STREAMLINING OF ALL APPLICABLE OPERATIONS.

AT THE HEART OF THIS EFFORT IS THE AUTOMATED COMMERCIAL SYSTEM (ACS). TODAY, AT NUMEROUS PORTS, WE HAVE ON-LINE A COMPREHENSIVE DATA BASE WITH ALL THE FUNCTIONS REQUIRED FOR PROCESSING ELECTRONICALLY TRANSMITTED OR MANUALLY PREPARED ENTRIES. THEREFORE, THE SYSTEM CAN EFFICIENTLY PROCESS ANY AND ALL ENTRIES PREPARED BY BROKERS. ALL REVENUE COLLECTED BY CUSTOMS IS PROCESSED THROUGH ACS, AS IS THE PREPARATION OF A DAILY BROKER STATEMENT. THE SYSTEM IS ALSO BEING INTEGRATED

INTO THE OPERATIONS OF LOCAL PORT AUTHORITIES AND MAJOR IMPORTERS. THE IMPORTING COMMUNITY IS COOPERATING IN ITS IMPLEMENTATION. ACS COMPRISES FIFTEEN PRIMARY SUBSYSTEMS SPECIFICALLY DIRECTED TO EACH OF THE MAJOR ACTIVITIES UNDER THE COMMERCIAL SYSTEM. MANY OF THESE MODULES ARE ALREADY IN FULL OPERATION. WHEN FULLY DEVELOPED AND IMPLEMENTED THE SYSTEM WILL PROVIDE IMPROVED MANAGEMENT INFORMATION, MORE EFFICIENT RESOURCE USE, AND INCREASED RESPONSIVENESS TO THE BUSINESS COMMUNITY.

FY 1987 PLANS

IN FY 1987, CUSTOMS IS PLANNING TO EXPAND AND FULLY DEVELOP ACS AS WELL AS DEVELOP AN UP-TO-DATE TREASURY ENFORCEMENT COMMUNICATIONS SYSTEM (TECS), APPLICABLE FOR TODAY'S ENFORCEMENT ENVIRONMENT.

AUTOMATED COMMERCIAL SYSTEM

THE $3.0 MILLION TO BE SPENT IN FY 1987 WILL ALLOW CUSTOMS TO CONTINUE EXPEDITED DEVELOPMENT AND IMPLEMENTATION OF THE FULL SYSTEM NEEDED TO RAISE PRODUCTIVITY AND CONTINUE EFFICIENT SERVICE AS THE WORKLOAD GROWS. WHEN COMPLETED, ACS WILL SUPPORT FULL SELECTIVITY, DETERMINING WHICH IMPORTS SHOULD BE INTENSIVELY EXAMINED AND THOSE ENTRIES WITH POTENTIAL CLASSIFICATION CHANGES AND INCREASED REVENUE. THIS ENHANCEMENT WILL PAY FOR ITSELF IN COST SAVINGS FOR CUSTOMS AND THE IMPORTING COMMUNITY. IN FY 1987, SYSTEM DEVELOPMENT AND HARDWARE EXPANSION FOR THE FOLLOWING MODULES WILL BE IMPLEMENTED: ANTIDUMPING/COUNTERVAILING DUTY, ENTRY SUMMARY SELECTIVITY, AIR MANIFEST, HARMONIZED SYSTEM AND THE CUSTOMS INFORMATION EXCHANGE.

TREASURY ENFORCEMENT COMMUNCIATION SYSTEM (TECS) II DEVELOPMENT

THE THRUST OF THE DESIGN AND DEVELOPMENT IS TO BUILD A COMPREHENSIVE ENFORCEMENT DATA BASE SYSTEM WHOSE UNDERPINNINGS ARE STATE-OF-THE-ART HARDWARE, SOFTWARE AND DATA BASE MANAGEMENT SYSTEMS. ALL CURRENT TECS USERS WILL CONTRIBUTE THEIR FIRST HAND EXPERIENCE TO INSURE THAT THE CURRENT DEVELOPMENT MEETS ALL

AGENCY REQUIREMENTS. THIS SYSTEM WILL PROVIDE FOR THE EXPANSION AND INTEGRATION OF THE EXISTING AUTOMATED ENFORCEMENT EFFORTS SUCH AS OPERATION EXODUS, THE TREASURY FINANCIAL LAW ENFORCEMENT SYSTEMS AND COMMERCIAL FRAUD, AS WELL AS OTHER ENFORCEMENT EFFORTS. THIS INITIATIVE WILL AFFORD CUSTOMS THE FLEXIBILITY TO MEET THE NUMEROUS INFORMATION REQUIREMENTS OF TODAY'S CUSTOMS ENFORCEMENT PROGRAM. THE $8.0 MILLION INVESTMENT WILL PROVIDE UPGRADED ASSISTANCE AND SUPPORT TO THE TEN ENFORCEMENT AGENCIES IN AND OUTSIDE TREASURY USING THE SYSTEM.

PROPOSED MANAGEMENT EFFICIENCIES

AS STATED IN MY PREVIOUS APPEARANCES BEFORE THIS SUBCOMMITTEE. OTHER CONGRESSIONAL GROUPS, AND BUSINESS AND INDUSTRY GROUPS, I BELIEVE AN IMPORTANT PART OF MY MANDATE AS COMMISSIONER OF CUSTOMS IS TO BRING TO CUSTOMS THE MOST EFFICIENT AND EFFECTIVE OPERATIONS AND MANAGEMENT POSSIBLE AT THE LOWEST POSSIBLE COST. AT THIS TIME, WHEN THE ENTIRE FEDERAL BUDGET MUST BE CLOSELY MONITORED TO ELIMINATE EXCESSIVE AND DUPLICATIVE COSTS; AND SIGNIFICANT BUDGETARY REDUCTIONS ARE REQUIRED, AS THIS SUBCOMMITTEE IS WELL AWARE, THIS GOAL BECOMES THE HIGHEST PRIORITY FOR ALL AGENCY MANAGERS. CUSTOMS IS NO EXCEPTION AND MUST SHOULDER ITS FULL SHARE OF THE CUTBACKS. THEREFORE, IN FY 1987, WE ARE PROPOSING TO INCORPORATE IN OUR BUDGET, MANAGEMENT INITIATIVES THAT WILL PRODUCE $21,131,000 IN SAVINGS. IN ADDITION TO A SELECTIVE HIRING POLICY, WHICH LIMITS HIRING TO PRIORITY ENFORCEMENT AND REVENUE PROTECTION PROGRAMS, THE CUSTOMS SERVICE WILL IMPLEMENT SPECIFIC PRODUCTIVITY SAVINGS DERIVED FROM STREAMLINED PORT AND DISTRICT OPERATIONS. CUSTOMS IS PROPOSING TO GO TO SINGLE SHIFTS AT AIRPORTS, CONSOLIDATE APPRAISEMENT CENTERS, REDUCE HOURS OF SERVICE AT PORTS DURING NON-PEAK TIMES, AND REDESIGNATE DISTRICTS. CUSTOMS PROCESSING AND ENFORCEMENT PROGRAMS WILL BE STRUCTURED AROUND THE CONCEPT OF A FULLY OPERATIONAL REDESIGNATED DISTRICT, STAFFED BY A FULL COMPLEMENT OF INSPECTORS, IMPORT SPECIALISTS AND OTHER ENFORCEMENT AGENTS. ENTRIES WILL CONTINUE TO BE FILED AS

PREVIOUSLY, BUT THE ACTUAL PROCESSING WILL BE AT THE APPROPRIATE DISTRICT OFFICE.

REPORT ON CUSTOMS ENFORCEMENT AND OPERATIONAL PROGRAMS

INSPECTION AND CONTROL

THE CUSTOMS INSPECTION AND CONTROL PROGRAM PROCESSES PERSONS AND CARGO, AND CLEARS CARRIERS, FOR BOTH REVENUE AND ENFORCEMENT PURPOSES. CUSTOMS EFFORTS TO IMPROVE ENFORCEMENT OF PERTINENT LAWS AND REGULATIONS AND EXPEDITE PROCESSING OF PERSONS AND GOODS WILL CONTINUE IN FY 1987. OUR OBJECTIVE, DESPITE RESOURCE CONSTRAINTS, IS TO ACHIEVE A BALANCE OF ECONOMICAL PROCESSING WHILE STILL MAINTAINING FULL SERVICE.

CUSTOMS WILL CONTINUE TO MEET THE CHALLENGE OF A GROWING WORKLOAD WHILE IMPROVING OVERALL EFFECTIVENESS THROUGH THE EXPANDED UTILIZATION OF AUTOMATED SYSTEMS, SELECTIVITY SYSTEMS AND OTHER INNOVATIVE TECHNIQUES. INCREASINGLY SELECTIVE AND AUTOMATED INSPECTIONAL TECHNIQUES WILL ENABLE CUSTOMS INSPECTORS TO CONCENTRATE THEIR EFFORTS ON THE "HIGH-RISK" PASSENGERS AND CARGO WHILE ALLOWING THE PREDOMINANTLY LAW-ABIDING TRANSACTIONS TO RECEIVE MINIMAL ATTENTION. WE WILL CONTINUE TO STREAMLINE CARGO PROCESSING THROUGH THE USE OF AUTOMATED TECHNOLOGY THAT WILL IMPROVE OUR ABILITY TO FACILITATE THE ENTRY OF MERCHANDISE WITHOUT WEAKENING OUR ENFORCEMENT POSTURE. OUR ENFORCEMENT EFFORTS WILL BE ENHANCED THROUGH THE USE OF FULLY IMPLEMENTED SELECTIVITY SYSTEMS. OUR SPECIAL TEAMS OF INSPECTORS, EQUIPPED WITH DETECTOR DOGS AND THE BEST POSSIBLE INTELLIGENCE WE CAN PROVIDE, WILL CONTINUE TO CONCENTRATE ON HIGH-RISK CARGO. THESE TEAMS HAVE ALREADY ESTABLISHED SIGNIFICANT COST-BENEFIT RATIOS WITH NOTEWORTHY NARCOTICS SEIZURES FROM CARGO AND BAGGAGE.

PASSENGER PROCESSING

AS IN PREVIOUS YEARS, CUSTOMS PROCESSED APPROXIMATELY 290 MILLION PERSONS ENTERING THE UNITED STATES, OF WHICH ALMOST 32 MILLION WERE AIR PASSENGERS. ALTHOUGH AIR PASSENGERS CONSTITUTE APPROXIMATELY 11 PERCENT OF THE TOTAL NUMBER OF

PERSONS ENTERING THE COUNTRY, THEY REQUIRE A DISPROPORTIONATE SHARE OF CUSTOMS RESOURCES DUE TO THE LIMITED FACILITIES AVAILABLE, AIRLINE PRESSURE FOR CUSTOMS PROCESSING AT SPECIFIC TERMINALS, AND THE SUBSTANTIAL CROWDING DURING PROCESSING. THE PROBLEM IS INTENSIFIED BECAUSE FLIGHT ARRIVALS AT AIRPORTS ARE CONCENTRATED WITHIN CERTAIN TIME PERIODS AND THE EXPANSION OF FACILITIES TO MEET WORKLOAD DEMANDS IS MINIMAL. HOWEVER, CUSTOMS HAS DEVELOPED AND IMPLEMENTED NEW HIGHER SPEED PROCESSING SYSTEMS TAILORED TO ACCOMMODATE THE PHYSICAL CONFIGURATION AND THREAT LEVEL OF EACH AIRPORT. THESE PROCESSING SYSTEMS ALLOW THE RAPID PROCESSING OF LAW-ABIDING TRAVELERS AND THE MORE EFFICIENT DETECTION OF SUSPECTED VIOLATORS.

ONE OF OUR MAJOR INITIATIVES FOR FY 1987 WILL BE REGULATORY CHANGES TO PRIVATE AIRCRAFT REPORTING PROCEDURES. UNDER THE PROPOSED RULEMAKING, REPORTING REQUIREMENTS FOR PRIVATE AIRCRAFT CONSIDERED A HIGH-RISK WILL BE MADE MORE STRINGENT, AND DETAILED JUSTIFICATIONS WILL BE REQUIRED FOR OVERFLIGHT EXEMPTIONS. IN ADDITION, MORE STRINGENT REPORTING REQUIREMENTS ARE BEING CONSIDERED FOR SMALL BOATS.

CARGO PROCESSING

CUSTOMS IS CONTINUING TO STREAMLINE ITS EFFORTS IN THE CARGO PROCESSING AREA. THESE EFFORTS ARE AIMED AT FACILITATING THE FLOW OF LEGITIMATE CARGO THROUGH OUR AIR AND SEA PORTS WHILE FOCUSING EMPHASIS ON SUSPECT SHIPMENTS. IN ORDER TO SPEED THE FLOW OF MERCHANDISE, WE ARE EXPANDING EXISTING CARGO SELECTIVITY AND ENHANCING OUR AUTOMATED CARGO PROCESSING SYSTEMS. THE MOST SIGNIFICANT INNOVATION HAS BEEN THE IMPLEMENTATION OF ACS CARGO SELECTIVITY. IT IS NOW IN OPERATION AT 45 MAJOR PORTS, AND ADDITIONAL SITES WILL BE IMPLEMENTED IN FY 1987. THE ENTIRE PROCESSING AND INSPECTION OPERATION IS DIRECTED BY A CENTRAL-SITE COMPUTER.

CONTRABAND ENFORCEMENT TEAMS

CONTRABAND ENFORCEMENT TEAMS (CET) ARE REINFORCING TRADITIONAL INSPECTIONAL OPERATIONS. THESE TEAMS GATHER AND DISSEMINATE INTELLIGENCE, PERFORM INPUT DOCUMENT REVIEW, AND ANALYZE AND SEARCH SUSPECT CARGO. WHENEVER VIOLATIONS ARE DETECTED, THE MERCHANDISE, DRUGS, CONTRABAND, AND ITEMS IN VIOLATION OF CURRENCY REPORTING AND EXPORT LAWS ARE SEIZED. CET CAPABILITIES HAVE BEEN BOLSTERED BY COMBINING THEIR SEARCH EFFORTS FOR DRUGS IN CARGO WITH THOSE OF THE CANINE TEAMS. AS A RESULT OF IMPROVED INTELLIGENCE GATHERING AND DISSEMINATION, CET TEAMS ARE NOW CAPABLE OF MORE SPECIFIC TARGETING OF POTENTIAL ILLEGAL ACTIVITIES, WHICH WE BELIEVE WILL RESULT IN MORE SIGNIFICANT SEIZURES. IN FY 1985, CET TEAMS SEIZED OVER 11,000 POUNDS OF COCAINE.

TARIFF AND TRADE PROGRAM

THE TARIFF AND TRADE PROGRAM IS RESPONSIBLE FOR APPRAISEMENT, CLASSIFICATION, DUTY ASSESSMENT AND COLLECTION ON ENTRIES OF IMPORTED MERCHANDISE, AS MANDATED IN THE TARIFF ACT OF 1930. RELATED AND EQUALLY IMPORTANT FUNCTIONS INCLUDE VERIFICATION OF IMPORT STATISTICS; ADMINISTERING NATIONAL TRADE POLICY BY MONITORING QUOTAS, STEEL IMPORT RESTRICTIONS, AND VARIOUS TRADE AGREEMENTS; AND, ENFORCEMENT OF LAWS AND REGULATIONS FOR OVER 40 OTHER FEDERAL AGENCIES.

IMPROVEMENTS IN THE COMPLETE RANGE OF TARIFF AND TRADE OPERATIONS ARE CONTINUING AND AN INDEPTH REVIEW OF THE MERCHANDISE PROCESSING SYSTEM IS UNDERWAY. OUR GOAL IS TO REDUCE THE BURDEN ON THE IMPORTER, ESPECIALLY THE COSTS OF DOING BUSINESS WITH CUSTOMS, WHILE INSURING THAT CUSTOMS MAINTAINS REQUIRED SERVICES EVEN WITH INCREASED MERCHANDISE IMPORTS. I AM PLEASED TO REPORT THAT OUR DEVELOPMENT PROJECTS ARE NOW OPERATIONAL. A BRIEF DESCRIPTION OF THESE INNOVATIONS IS INCLUDED TO PROVIDE YOU WITH SOME INSIGHT INTO THE NEW BUSINESS METHODS CUSTOMS HAS IMPLEMENTED.

AUTOMATED COMMERCIAL SYSTEM

ACS IS NOW PROCESSING MERCHANDISE ENTRIES, REVENUE COLLECTIONS, ENTRY LIQUIDATIONS, AND AN INCREASING NUMBER OF BROKER TRANSACTIONS. ON THE COMMERCIAL SIDE, ACS IS SELECTIVELY DIRECTING INSPECTORS TO MERCHANDISE REQUIRING EXAMINATION AND IMPORT SPECIALISTS TO CLASSIFICATION OR VALUE CHANGES. AS FOREIGN TRADE RISES, PROPER INSPECTION, EXAMINATION, VALUATION, AND CLASSIFICATION ARE NEEDED TO ENSURE THAT ALL DUTIES ARE COLLECTED.

AUTOMATED INTERFACE WITH BROKER, IMPORTER AND PORT AUTHORITY COMPUTERS IS A KEY FEATURE OF THE SYSTEM. CURRENTLY, TWENTY PERCENT OF THE ENTRY SUMMARIES PRESENTED TO CUSTOMS ARE PREPARED VIA THIS INTERFACE AND THAT NUMBER IS EXPECTED TO GROW BY 1987. CUSTOMS VIEWS THIS AS A UNIQUE OPPORTUNITY FOR BOTH THE TRADE COMMUNITY AND CUSTOMS TO WORK TOGETHER.

SELECTIVITY CRITERIA, WHICH ALSO IS IMPORTANT FOR BOTH CARGO EXAMINATION AND IMPORT SPECIALIST REVIEW, WILL BE MAINTAINED IN A UNIFIED DATA BASE. THE SYSTEM WILL BE CAPABLE OF IDENTIFYING THE TYPES OF REVIEW REQUIRED BY THE IMPORT SPECIALIST. AS IS COMMON IN THIS TYPE OF PROCESSING, RANDOM SAMPLING WILL MAINTAIN SYSTEM INTEGRITY.

TARIFF AND TRADE PROGRAM PARTICIPATION IN CUSTOMS OVERALL ENFORCEMENT EFFORT INCLUDES THE EXPANSION OF IMPORT SPECIALISTS' ROLE IN FRAUD TEAMS, SPECIAL ANALYTICAL TEAMS, TARGETING SPECIFIC COMMODITIES AND VIOLATORS, AND IN ASSESSMENT OF PENALTY CASES.

AIR PROGRAM

A PRIMARY CONCERN OF THE CUSTOMS SERVICE AND THE TREASURY DEPARTMENT HAS BEEN THE EFFECTIVENESS OF THE AIR INTERDICTION PROGRAM AS A DETERRENT AGAINST THE SMUGGLING OF NARCOTICS AND CONTRABAND BY PRIVATE AIRCRAFT, A THREAT THAT HAS DRAMATICALLY

INCREASED OVER THE PAST SEVERAL YEARS. IN FY 1985, THE CUSTOMS AIR PROGRAM SEIZED 15,539 POUNDS OF COCAINE, A 64 PERCENT INCREASE OVER FY 1984. THE AMOUNT OF COCAINE SEIZED BY CUSTOMS THAT WAS SMUGGLED INTO THE COUNTRY BY PRIVATE AIRCRAFT INCREASED FROM 20 PERCENT IN FY 1984 TO 31 PERCENT IN FY 1985.

IN AN EFFORT TO MOST EFFECTIVELY RESPOND TO THIS SERIOUS PROBLEM, CUSTOMS AIR OPERATIONS HAS ADOPTED A STRATEGY OF CONCENTRATING AIR PERSONNEL AND EQUIPMENT IN HIGH-THREAT AREAS AND USING THEM IN CONFORMANCE WITH THE DETECTION, INTERCEPTION AND TRACKING METHODS DEVELOPED SPECIFICALLY FOR THE INTERDICTION OPERATIONS CONFRONTING CUSTOMS AIR UNITS. DETECTION SYSTEMS IDENTIFY SUSPECT AIRCRAFT AND DIRECT APPREHENSION HELICOPTERS AND GROUND SUPPORT UNITS TO THE PRECISE LOCATION TO CAPTURE THE SMUGGLERS.

IN FY 1986, CUSTOMS IS REQUESTING $52,500,000 FOR AIR PROGRAM OPERATIONS AND MAINTENANCE, WHICH INCLUDES THE GRAMM-RUDMAN REDUCTION AND A PROPOSED RESCISSION. THE FY 1987 BUDGET TOTAL OF $54,700,000 INCLUDES ONLY SUFFICIENT ADDITIONAL FUNDS FOR PROJECTED COST INCREASES. IN BOTH YEARS THE PROPOSED BUDGET LEVELS WILL SUPPORT CONTINUED FULL OPERATIONS OF ALL CUSTOMS AIR UNITS CURRENTLY AVAILABLE.

IN CONTRAST TO FY 1985, FOUR P-3A DETECTION AIRCRAFT WILL BE OPERATIONAL THIS YEAR; THEY ARE SCHEDULED TO OPERATE AN AVERAGE OF 100 HOURS PER MONTH. IN SUPPORT OF THE ANTICIPATED INCREASE IN DETECTED SMUGGLER AIRCRAFT, THE PROGRAM WILL BE OPERATING EIGHT NEW HIGH ENDURANCE TRACKER AIRCRAFT. THE FIRST OF THESE AIRCRAFT IS EXPECTED IN MARCH, 1986, WITH THE REMAINDER BECOMING AVAILABLE BY JULY, 1986.

SUFFICIENT FUNDS ALSO ARE AVAILABLE DURING THESE YEARS FOR TWO SIGNIFICANT PROGRAM ENHANCEMENTS: FOR THE PREPARATIONS NECESSARY TO BEGIN THE ESTABLISHMENT OF TWO COMMAND, CONTROL, COMMUNCIATIONS, AND INTELLIGENCE CENTERS (C-3I) INCLUDING FACILITIES DESIGN, SITE SELECTION, AND PURCHASE OF CORE EQUIPMENT; AND, THE MODIFICATION OF FOUR C-12 MARINE SUPPORT AIRCRAFTS. CURRENTLY, WE ARE PROPOSING SOUTHERN CALIFORNIA AND FLORIDA AS THE TWO LOCATIONS FOR THESE CENTERS. ONCE IN FULL OPERATION, THESE CENTERS WILL, FOR THE FIRST TIME, PERMIT CUSTOMS TO PLACE RADAR SIGHTINGS, AND INTERCEPTIONS UNDER A SINGLE INTEGRATED COMMAND SYSTEM. WE BELIEVE THAT THIS MAJOR ENHANCEMENT WILL IMPROVE OUR OVERALL INTERCEPTION RATE. FINALLY, THE FOUR OPERATING C-12'S MODIFIED WITH AN ADVANCED DOWN LOOKING RADAR, SPECIALLY DESIGNED FOR OVER WATER DETECTION, WILL FILL A CRITICAL GAP IN MARINE SURVEILLANCE OPERATIONS.

MARINE PROGRAM

IN CONJUNCTION WITH THE AIR PROGRAM, CUSTOMS MARINE PROGRAM PROTECTS THE SEA APPROACHES TO THE NATION'S BORDERS. CONFRONTED WITH SIMILAR GROWTH IN ITS SMUGGLING PROBLEM, BY THE END OF FY 1986, THE PROGRAM WILL HAVE 218 OPERATIONAL VESSELS, RANGING IN SIZE FROM 15 TO 55 FEET, STATIONED AT 55 LOCATIONS. ALSO, CUSTOMS NEWLY DEVELOPED OPERATIONAL APPROACH INCLUDES MARINE MODULES AND A SPECIAL BLUE LIGHTNING STRIKE FORCE, ALL OF WHICH WILL BE OPERATING DURING FY 1986. THESE VESSELS ARE USED FOR SURVEILLANCES, WATERSIDE RAIDS, INTELLIGENCE GATHERING, AND INTERDICTION. TODAY'S INTERDICTION UNITS CONFRONT LARGE-SCALE SMUGGLERS USING "MOTHERSHIPS", STASHES ON OFF-SHORE ISLANDS AND "AIR DROPS". RECENT SEIZURES INDICATE THAT MAJOR SMUGGLING BY VESSEL IS STILL ACTIVE IN THE SOUTHEAST, PARTICULARLY FROM THE BAHAMAS IN FAST BOATS, THE GULF COAST AND IS INCREASING ALONG THE PACIFIC, MID-ATLANTIC AND NEW ENGLAND COASTAL AREAS.

TO COUNTER THE THREAT OF SMUGGLING BY PRIVATE AND FISHING VESSELS, CUSTOMS HAS ESTABLISHED THE BLUE LIGHTNING STRIKE FORCE. THE CONCEPT OF SUCH A FORCE WAS DEVELOPED FROM OPERATION BLUE LIGHTNING, INAUGURATED IN APRIL, 1985, AS PART OF AN NNBIS COORDINATED MULTIAGENCY FORCE FOR DISRUPTING THE FLOW OF DRUGS

FROM THE BAHAMAS. BY PRESSURING THE SMUGGLERS TO DRASTICALLY CHANGE THEIR NORMAL TRAFFICKING PATTERNS, SIGNIFICANT AMOUNTS OF DRUGS WERE SEIZED. AS A RESULT OF OPERATION BLUE LIGHTNING, 36,000 POUNDS OF MARIJUANA, 5,500 POUNDS OF COCAINE, AND 26 VESSELS WERE SEIZED DURING A TWO\ WEEK OPERATION.

IN CONVERTING THE CONCEPT TO A PERMANENT OPERATIONAL APPROACH, CUSTOMS AND OTHER PARTICIPATING AGENCIES COORDINATE ACTIVITIES ON A 24-HOUR BASIS ALONG THE FLORIDA COAST. DURING THE FIRST 90-DAYS OF THE OPERATION THERE WERE 82 ARRESTS, AND THE SEIZURE OF 103,755 POUNDS OF MARIJUANA, 6,710 POUNDS OF COCAINE, 5 AIRCRAFT, AND 32 VESSELS. SINCE ITS ESTABLISHMENT AS A PERMANENT FORCE, CUSTOMS IS STRENGTHENING ITS CAPABILITIES BY IMPLEMENTING AN OPERATIONS CENTER, THE JOINT MARINE INTERDICTION COMMAND CENTER (J-MICC), WHICH WILL INTEGRATE DETECTIONS AND OPERATIONAL UNITS. THE CENTER WILL FUNCTION UNDER MULTIAGENCY COMMAND AND CONTROL AND WILL COORDINATE OTHER FEDERAL AND PARTICIPATING STATE AND LOCAL MARINE UNITS ALONG THE FLORIDA COAST AS FAR NORTH AS FORT PIERCE ON THE EAST COAST.

INVESTIGATIONS

CUSTOMS INVESTIGATIVE PROGRAM IS RESPONSIBLE FOR VIOLATIONS OF CUSTOMS AND RELATED LAWS, WHICH INCLUDES A BROAD MANDATE TO CONDUCT CURRENCY, FRAUD, EXPORT AND INTERNATIONAL ENFORCEMENT CASES. IN EACH PROGRAM, TARGETING DEPENDS HEAVILY UPON THE DEVELOPMENT AND COLLECTION OF INTELLIGENCE. THE MAIN PROGRAMS ARE DESCRIBED BELOW.

ORGANIZED CRIME DRUG ENFORCEMENT (OCDE)

CUSTOMS PARTICIPATES WITH OTHER FEDERAL LAW ENFORCEMENT AGENCIES IN 13 CITY TASK FORCES. THE FINANCIAL INVESTIGATIONS FOCUS ON SMUGGLING GROUPS RESPONSIBLE FOR THE LAUNDERING OF LARGE SUMS OF MONEY. WE BELIEVE THIS PROGRAM IS A MAJOR STEP IN ASSURING THE SUCCESS OF THE PRESIDENT'S GOAL OF DISRUPTING ORGANIZED CRIME THROUGHOUT THE COUNTRY.

IN FY 1987, CUSTOMS PLANS TO CONTINUE WITH CURRENT COMMITMENTS OF RESOURCES TO THE PRESIDENTIAL ORGANIZED CRIME DRUG ENFORCEMENT TASK FORCES. THESE SPECIALIZED INVESTIGATIVE TASK FORCES FOCUS ON LARGE-SCALE DRUG SMUGGLING ORGANIZATIONS, APPROACH EACH TARGET AND SIMULTANEOUSLY EXPLOIT THE FINANCIAL, INTERNAL CONSPIRACY AND INTERDICTION/SMUGGLING ELEMENTS OF EACH CRIMINAL ORGANIZATION. TO DATE THEY HAVE ACHIEVED EXCELLENT RESULTS. IN FY 1985, CASES INVOLVING CUSTOMS PARTICIPATION RESULTED IN 909 INDICTMENTS, 547 ARRESTS; 405 CONVICTIONS; $34 MILLION IN U.S. CURRENCY AND PROPERTY SEIZURES; SEIZURES OF 218 POUNDS OF COCAINE AND 53 POUNDS OF HEROIN;AND $8 MILLION IN FINES COLLECTED

FRAUD PROGRAM

FOR SEVERAL YEARS, CUSTOMS HAS EMPHASIZED ITS FRAUD EFFORTS AGAINST ILLEGAL UNAUTHORIZED STEEL, TEXTILE, AND WEARING APPAREL IMPORTS, AS WELL AS DRAWBACK AND TRADEMARK AND COPYRIGHT VIOLATIONS. THESE EFFORTS HAVE PRODUCED GOOD RESULTS IN TERMS OF PENALTY RECOVERIES AND PROSECUTIONS OF CRIMINALS. ALSO, DOMESTIC INDUSTRY AND JOBS WERE PROTECTED FROM UNFAIR AND ILLEGAL INTERNATIONAL TRADE PRACTICES. OPERATION TRIPWIRE, WHICH IS THE DESIGNATION OF OUR SPECIAL EMPHASIS AGAINST FRAUDULENT IMPORTS, ACCOUNTED FOR 54 ARRESTS, 230 INDICTMENTS, AND SEIZURES WITH A TOTAL VALUE OF OVER $67 MILLION IN FY 1985.

AS REPORTED FOR THE PAST SEVERAL YEARS, CUSTOMS IS LOOKING VERY CAREFULLY AT ALL STEEL AND TEXTILE IMPORTS. TASK FORCE OPERATIONS IN FY 1986 WILL CONTINUE TO DIRECT THEIR EFFORTS AGAINST ILLEGAL MERCHANDISE BEFORE IT ENTERS UNITED STATES COMMERCE AND TO INVESTIGATE CASES RESULTING FROM INTENSIFIED INSPECTIONS. THE TASK FORCES WILL FOCUS ON HIGH-RISK IMPORTATIONS AT MAJOR PORTS TO ASSURE CONTINUED HIGH QUALITY ARRESTS, MAJOR REVENUE RECOVERIES AND TO PRESENT A VISIBLE DETERRENT.

A SIGNIFICANT IMPROVEMENT IN CUSTOMS EFFECTIVENESS WILL

OCCUR WHEN THE EXPANDED CAPABILITY TO TARGET VIOLATORS, BY CORRELATING COMMERCIAL, FINANCIAL AND ECONOMIC DATA USING ADP SYSTEMS, WITHIN SELECTED "HIGH-RISK" AREAS, IS FULLY IMPLEMENTED. TO THIS END, WE ARE USING INTEGRATED FUNCTIONAL TEAMS, IN HIGH-ACTIVITY AREAS, TO OBTAIN INTELLIGENCE AND ENFORCEMENT EFFECTIVENESS.

FINANCIAL LAW ENFORCEMENT PROGRAM

OUR INVESTIGATIVE ATTACK ON CRIMINAL ORGANIZATIONS UNDER PROVISIONS OF THE BANK SECRECY ACT AND THROUGH THEIR FINANCIAL TRANSACTIONS HAS PAID EXCELLENT DIVIDENDS IN TERMS OF ITS IMPACT ON THE LARGEST SMUGGLING GROUPS OPERATING IN THIS COUNTRY. MULTI-AGENCY INVESTIGATIVE AND PROSECUTORIAL TEAMS, OPERATING UNDER THE LEADERSHIP OF THE LOCAL U.S. ATTORNEY, ARE CURRENTLY ACTIVE IN CITIES WITH LARGE-SCALE CURRENCY MOVEMENTS AND THOSE CITIES IN THE FOREFRONT OF TOP-LEVEL DRUG TRAFFICKING AND MONEY LAUNDERING.

OUR FINANCIAL ANALYSIS DIVISION (FAD) IS THE CLEARING HOUSE FOR ALL FINANCIAL DATA. THE CENTER ANALYZES THE FINANCIAL CHARACTERISTICS OF CRIMINAL MARKETS AND ASSISTS IN DEVELOPING USEABLE STRATEGIES FOR EXPLOITING CRIMINAL FINANCIAL BUSINESS PRACTICES. NEEDLESS TO SAY, THE CENTER IS ALSO THE SOURCE OF INTELLIGENCE, BOTH DOMESTIC AND FOREIGN, DEVELOPED AND ADAPTED FOR THE INVESTIGATIVE FIELD UNITS. DURING FY 1985, FAD IDENTIFIED INDIVIDUALS AND COMPANIES SUSPECTED OF LAUNDERING OVER A BILLION DOLLARS.

OPERATION EXODUS

OPERATION EXODUS COMBATS ILLEGAL EXPORTS OF EQUIPMENT, COMPUTER PARTS, CLASSIFIED DEFENSE ITEMS, AND LASERS. IN ADDITION, AND EQUALLY SERIOUS, IS THE ILLEGAL TRANSFER OF TECHNICAL DATA ON RESEARCH, DEVELOPMENT, AND MANUFACTURING. OUR JOB IS NOT ONLY TO DETECT THESE SHIPMENTS, BUT ALSO TO PUNISH THE INDIVIDUAL VIOLATORS. ULTIMATELY, IF WE ARE TO BE SUCCESSFUL, WE MUST DISCOURAGE THE ACTIVITIES OF THE

MANUFACTURERS, OVERSEAS INTERMEDIARIES, AND FOREIGN OPERATIVES. I AM PLEASED TO REPORT THAT WE ARE RECEIVING THE STRONG SUPPORT OF AMERICAN INDUSTRY IN THIS EFFORT.

CUSTOMS ACTIVITIES IN THIS PROGRAM IN FY 1987, WILL FOCUS ON TARGETING ILLEGAL EXPORTS WHILE MINIMIZING THE IMPACT ON LEGITIMATE TRADE. EXPANDED USE OF SPECIFICALLY TARGETED ENFORCEMENT OPERATIONS CONCENTRATING ON HIGHLY SELECTIVE CRITICAL EXPORTS, INCREASED FOREIGN INFORMATION, AND ADP GENERATED ANALYTICAL INTELLIGENCE ARE CRITICAL ELEMENTS FOR IMPROVING OVERALL EFFECTIVENESS. IN FY 1987, A WIDE RANGE OF ENFORCEMENT INITIATIVES WILL BE IMPLEMENTED: ADDITIONAL UNDERCOVER OPERATIONS; AN EXPANDED MUNITIONS CONTROL PROGRAM; ENHANCED LIAISON WITH THE INTELLIGENCE COMMUNITY; INCREASED FOREIGN COOPERATION; AND, SUPPORT AND ASSISTANCE TO FOREIGN GOVERNMENTS IN THEIR OWN CONDUCT OF OPERATIONS DIRECTED AGAINST EXODUS VIOLATIONS.

PORNOGRAPHY

THE PAST DECADE HAS SEEN SUBSTANTIAL GROWTH IN PORNOGRAPHY TRAFFICKING. IT IS A PROBLEM OF PRIME CONCERN AND CUSTOMS HAS STEPPED UP THE LEVEL OF ENFORCEMENT IN THIS AREA. WE ARE AGGRESSIVELY INVESTIGATING PORNOGRAPHY CASES, ESPECIALLY WHERE LARGE VOLUME DEALERS, ORGANIZED CRIME, OR CHILD PORNOGRAPHY ARE INVOLVED. SINCE PORNOGRAPHY IS SMUGGLED INTO THE UNITED STATES CHIEFLY THROUGH THE MAILS, WE HAVE A VITAL ROLE IN CURBING THE IMPORTATION OF PORNOGRAPHIC MATERIALS AND SEEKING PROSECUTION OF VIOLATORS OF CUSTOMS AND RELATED LAWS. TO ACCOMPLISH THIS, CUSTOMS, TOGETHER WITH OTHER FEDERAL, STATE, LOCAL AND FOREIGN AUTHORITIES, IS WORKING TO STEM THE FLOW OF IMPORTATION AT THE SOURCE COUNTRIES. AS A RESULT OF CUSTOMS' INVESTIGATIVE EFFORTS SEVERAL CHILD PORNOGRAPHERS HAVE BEEN IDENTIFIED AND ARRESTED.

CONCLUSION

IN CLOSING, WE WISH TO REITERATE THAT OUR BASIC MISSION IS THE COLLECTION OF REVENUE AND ENFORCEMENT OF CUSTOMS AND RELATED

LAWS. OUR MISSION IS IMPORTANT AND OPERATES IN A DYNAMIC ENVIRONMENT, SIGNIFICANT ELEMENTS OF WHICH INCLUDE THE TRAVELING PUBLIC, THE TRADE COMMUNITY, AMERICAN BUSINESS AND THE GENERAL PUBLIC. CUSTOMS, IN FULFILLING ITS RESPONSIBILITIES, MUST INCREASINGLY EMPLOY SOPHISTICATED OPERATIONAL AND ENFORCEMENT TECHNIQUES AND A WIDE VARIETY OF SKILLS AND DISCIPLINES.

IN FY 1986, DESPITE THE IDENTIFIED REDUCTIONS, CUSTOMS WILL CONTINUE IMPROVING COMMERCIAL MERCHANDISE PROCESSING AS WELL AS UPGRADING ITS VITAL TECS SYSTEM. WHEREVER POSSIBLE, SELECTIVE APPROACHES SUPPORTED BY AUTOMATION AND REDUCED PROCEDURAL REQUIREMENTS WILL BE IMPLEMENTED. IN EACH CASE, WE ARE ATTEMPTING TO SPEED UP THE PROCESSING TIMES. AS DESCRIBED EARLIER, WE WILL BE WORKING CLOSELY WITH THE IMPORTING COMMUNITY TO INSURE THAT THE PLANNED OPERATING SYSTEM MEETS THEIR NEEDS AS WELL AS OUR OWN.

TODAY, I HAVE OUTLINED A BLUEPRINT OF FUTURE DIRECTIONS AND OF IMPROVEMENTS RECENTLY IMPLEMENTED. IN FY 1987, WE SHOULD BEGIN TO SEE THE RESULTS OF THESE EFFORTS AS MANY OF THE INNOVATIONS BECOME FULLY OPERATIONAL.

THIS CONCLUDES MY INTRODUCTORY STATEMENT. WE ARE AVAILABLE TO DISCUSS THE DETAILS OF THE REQUEST AND ANSWER YOUR QUESTIONSAND THOSE OF THE SUBCOMMITTEE MEMBERS.

SUMMARY STATEMENT

Mr. von Raab. I know that you and your staff, Senator DeConcini and his staff, and Senator Mattingly and his staff are intimately aware of the details of Customs programs and Customs budget. I am sure that you would like to move on to your specific questions as soon as possible. So in the spirit of Gramm-Rudman as applied to statements, I too will reduce my formal statement to an informal and very brief summary.

Our budget this year is complicated by the passage of Public Law 99–177 in the middle of the 1986 year, following closely after the passage and signing of our continuing resolution. On top of that we are appearing before you to discuss our 1987 proposals. Perhaps I could try to explain what is before you and how it really affects the Customs Service.

Our authorized level provided by the continuing resolution would have been $717 million in the "Salary and expenses" account. That is not the "Air operations" account. This would have given us an authorized level of 14,041 average positions.

Gramm-Rudman-Hollings legislation, Public Law 99–177, required us to reduce our operating budget by around $31 million which is equivalent to, and is largely taken by, the elimination of vacancies in the amount of 777 personnel.

I say vacancies because Customs was operating under a hiring freeze as well as other budget constraints prior to the continuing resolution, which subsequently increased our position level. We did not have enough time to fill some of the new positions, therefore, we used these vacancies to help meet our Gramm-Rudman reduction.

In addition to that, there was a $4 million rescission taken out of a number of programs, such as travel and training and other discretionary programs which would bring us down in 1986 to an operating level of $682 million, or full-time equivalents of 13,264.

Bringing those numbers through to 1987, we are required to take approximately a $21 million decrease which converts into 770 average positions. In this case, a large number of these would be reductions in existing personnel. For the most part, these would be taken through attrition, although we do not anticipate that any employees would be RIF'd in order to meet these requirements.

In order to more fully explain the numbers, just to maintain our current levels requires about $25 million; we also have an increase for the automated commercial system of $3 million, and an increase of $8 million to improve our TECS lookout, or TECS enforcement system. Therefore, our budget includes increases of $11 million for the enhancements and $25 million for maintaining current levels.

This brings us to a budget proposal for fiscal year 1987 of $693 million which would allow us to employ 12,494 personnel on a full-time equivalent basis. In constructing this budget, we were driven by the Gramm-Rudman constraints, but we have attempted to construct it in such a way that we have minimized the impact on our drug programs, our export technology program, and also our textile program.

I believe that we will be successful in doing that. The budget is not the kind of a budget that would be hoped for, but as I said, Gramm-Rudman has put us in the position of having to take these reductions. I am confident that we will be able to maintain current levels of drug interdiction. As a matter of fact, if you look at our current levels, you will see that the number of boats and planes we will have this year are greater than last year.

However, they will not increase substantially next year. It is true that in the continuing resolution, there would have been significantly greater additions both to our salaries and expenses budget and to our air operations and maintenance budget. The air budget, of course, is another situation because the reductions in 1986 are considerably greater, and I know you will be going into that. Those reductions are approximately $19 million for a rescission, and $3 million for Gramm-Rudman.

A slight increase in fiscal year 1987 against the fiscal year 1986 reduced amount to maintain current levels will basically take us from a continuing resolution authorized level of $75 million to fiscal year 1986 proposed level of $52.5 million, and fiscal year 1987 requested level of $54.7 million for the air operations and maintenance program.

I will be happy to answer Senator Mattingly's questions in whatever form or in whatever way you would like.

Senator ABDNOR. I think we will just have you do that in writing. That will be fine.

Mr. VON RAAB. Fine.

Senator ABDNOR. That way you have a chance to get some things together.

Mr. VON RAAB. That is a brief explanation of our budget. As I said, I have a formal statement, but in the interest of proceeding as you and the Senator seem to like, I will get right on to your specific questions.

Senator ABDNOR. Fine. As I say, the entire statement will be made a part of the record, and we will certainly review it. Are you comfortable with this budget? In your mind, are you going to do everything you want to do?

Mr. VON RAAB. No; I am not comfortable with this budget, but as I indicated, we are all required by virtue of Gramm-Rudman to take reductions, and we have tried to take these reductions in such a way as to keep our high priority programs as strong as possible.

I do not feel that we will lessen our effectiveness.

Senator ABDNOR. I am talking about 1987 now. I mean this budget we are going to be talking about for 1987.

Mr. VON RAAB. That is right. In effect, the reductions in 1987 are not exactly Gramm-Rudman ordered, but they are Gramm-Rudman driven. This is what is required of Customs in order to enable the administration to meet the Gramm-Rudman cuts.

Senator ABDNOR. Does it bother you a little bit, though, Commissioner, to see the challenge you have and the tension that has gathered throughout the Nation about this horrible—I am just talking about drugs now. I have a lot of other thoughts, but that keeps running through my mind because I am seeing more of it in South Dakota, and I know it is all over the country. I know what a big thing it is supposed to be for Nancy Reagan down at the White House. This is the thing I do not understand. Some people, not you particularly, but whoever puts this together, expect you to stop this stuff from coming in the country. Does it not bother you to see that FBI gets $120 million more for their fight on drugs and DEA gets $40 million. They do not worry about Gramm-Rudman down there. You keep talking about Gramm-Rudman.

Why do you think OMB, or whoever puts this thing together felt that they were going to do a better job of running down this stuff than you are?

Mr. VON RAAB. I do not know the answer to that. I can only read the OMB reports which state that this budget, the overall budget reflects a shift of moneys from interdiction to investigations, and so I have to assume that the higher level policymakers have reviewed the possibilities of interdiction and investigations and have made a determination that they should put more into investigations.

Senator ABDNOR. I have to believe that it is a lot easier to try to control the problem catching it when it enters the country than it is trying to smoke them out once they get it inside and go underground with it.

Mr. VON RAAB. I think that is particularly true, by the way, in the case of cocaine because as long as the supply coming across the border is enormous, there will always be smaller or larger groups that will be prepared to spring up in the United States to sell that supply. I think until we get the cocaine down to a more controllable level in the United States, the application of investigations to that, although certainly very important, is probably less important than the interdiction of cocaine.

Senator ABDNOR. You mentioned briefly Gramm-Rudman-Hollings. I guess your answer was that you met that cut by releasing or never employing the 777 employees that we intended to put on the payroll for the Customs in this 1986 year. That is how you cut.

Mr. VON RAAB. That is right. At the hearing at which you presided, I presented to your committee an authorization to hire 797 personnel from June through December. Given the slowness of the governmental hiring process, we were never able to hire all of those, therefore, we removed hiring permission for 600 of those 777. Of the other 177 vacancies we reduced, we had never actually authorized them. We were waiting to see how the 797 were applied and where we should put the additional 177.

Senator ABDNOR. How many more vacancies in addition to the 777?

Mr. VON RAAB. I guess I always think of vacancies in terms of slots we could fill with the money that we have. If you are asking me how many people could we hire today under the funding levels at which we are operating, after Gramm-Rudman and the rescissions, the answer would be only a handful. We would only be talking about a half dozen people at most above normal filling of slots as they are vacated by retirements or other terminations of service.

We are right now operating at a level for which we are funded.

Senator ABDNOR. You are taking, at least for the budget that we are looking at, 21 million less for next year; right?

Mr. VON RAAB. That is correct. That is equivalent to 770 average positions.

Senator ABDNOR. That is going to involve 770 more. Those are people who will have to come out of your numbers?

Mr. VON RAAB.Yes; that will be people who are on board, but as I indicated, we do not expect to RIF anyone because our attrition rates are typically high enough to pick up that number of people over a year.

Senator ABDNOR. What kind of spots are you going to try to eliminate? I mean you are going to have to be selective here pretty quick. We think you need more. You have less. Now you are going to take another big group. You are not just going to take whoever is retiring and leave that particular spot go, surely? To make up 770 individuals, in what area are you going to least feel the impact of their loss? So what kind will you try to leave out or eliminate?

Mr. VON RAAB. Our proposals for these savings will come out of four basic areas. First, we will implement a selective hiring policy which we believe will save approximately 385 positions and about $10 million.

What we will do there is basically fill only critical or essential vacancies. These numbers necessarily would fall largely in the inspectional area, probably around 220 inspectors or support to inspectors.

Second, in the area of appraisement we would expect to reduce around 150 import specialists as a result of productivity savings from our improved automated systems and through the consolidation of appraisement centers. We are also looking at possible savings of around 235 personnel through changes in our port operations. In this case, limiting service at nonpeak hours, redesignating districts, and taking other steps to reduce staffing requirements over time and support costs. I would point out, however, that the last proposal is under study due to the passage of the budget reconciliation bill by both Houses of Congress.

When it is signed by the President, it will have significant impact on our inspectional operations, and I would only say that this streamlining of port operations, as we describe it, is our present plan to make some of these savings. We will have to make sure that we do this in conformance with the changes that are contained in the Budget Reconciliation Act.

Senator ABDNOR. I was just noticing that the number of inspectors shows that you have 3,970 on hand. I think that is what it says. One time in 1986 you had a few less. You have dropped your numbers. In 1980–84 you had far more inspectors. You have dropped quite a few.

I cannot help but notice the value of the imports. In 1984 when you had 4,289 inspectors you had $316 billion worth of imports. In fiscal year 1987, you got it down from there about 500 people—maybe a little higher—300 and some. But you are up to $382 billion. This thing is nothing but growing. You must have a better system all the time of doing this inspecting.

When things are growing in volume, it gets to be more and more of a load, but you seem to think we can do with less and less people. I am just trying to remember if in the new water bill we are passing, the part that has come out of Finance Committee, means you are going to have to start collecting—I think you people are the ones who are going to be collecting the fees.

What is going to happen on that? Are you going to absorb that one, Mr. Commissioner, when it becomes your responsibility to collect ad valorem tax coming into the ports all over the Nation? That is going to be quite an added burden for you. Who is going to reimburse you for that?

Mr. VON RAAB. That is true. I would like Mr. De Angelus to respond to those questions with respect to workload and Customs work force.

Mr. DE ANGELUS. Senator, we anticipate with the Harbor Dredging Act and with the user fees that the House version will be adopted with regard to reimbursement to the Customs Service for costs incurred.

Over the past 5 years, we have followed a policy of no tickey no washie, and we have insisted that other agencies reimburse us for the major things we do for them. We hope that the Congress when they take final action on this bill will permit us to be reimbursed by the Corps of Engineers for collecting these fees.

Senator ABDNOR. I did not write that section of the bill. Tht came through Finance. All we did was make it possible to build the harbors. Somebody else tells them how to pay. We just worked on that bill yesterday and passed it. Have you any idea what it is going to cost you for collecting those? Every port in the United States is going to be part of this.

Mr. DE ANGELUS. We anticipate that our costs will be somewhere between $4 and $5 million, Senator, to collect $150 million for the Corps of Engineers. We believe that we can collect on imports at virtually zero costs because of the kind of systems we have established already to collect duties on imports.

However, with regard to exports, there will be some additional personnel required and for both imports and exports some additional verifications and investigations will be required.

We believe the total will be $5 million.

Senator ABDNOR. Are you in every port in the country of any consequence that mjght be bringing in goods?

Mr. DE ANGELUS. We are at 317 locations, Senator. In every seaport in which cargo is permitted to be imported, Customs is present. Some places where there is coastline movement of domestic cargo Customs is not present. However, we hope that will be worked out with the Internal Revenue Service on a reimbursable basis.

Senator ABDNOR. You will have to have people up there at the Great Lakes, too, now?

Mr. DE ANGELUS. That is correct, Senator.

Senator ABDNOR. I do not know if you have been there before or not. Maybe I better keep wondering about this when we go to conference and make sure that somebody does put some money into your accont.

Mr. De Angelus. We think we are very efficient and we can do things for other agencies in a very efficient manner. However, we do like to be reimbursed for that extra work, Senator. Yes; thank you.

Senator Abdnor. I am not so sure our version calls for reimbursement. But we better make sure somebody tries to look out for you here. Before we get off of this, I do not want to leave Gramm-Rudman-Hollings without asking you to give me a more detailed report, Commissioner, on these numbers and dollars and how it all works out for our record.

Mr. von Raab. Do you want me to do that right now?

Senator Abdnor. No, no; just submit it for the record.

Mr. von Raab. Fine.

[The information follows:]

FISCAL YEAR 1986 GRAMM-RUDMAN-HOLLINGS REDUCTIONS

	FTE	Amount
Salaries and expenses:		
Freeze additional assets provided in the continuing resolution	177	$8,000,000
Selective hiring policy, except for priority enforcement program	547	12,000,000
Relocations		1,000,000
Noncritical travel		1,800,000
Training		1,800,000
Purchase of information/evidence		500,000
Marine enhancements		3,500,000
Streamline port operations	53	1,300,000
Special operations		900,000
Total	777	30,800,000
Operations and maintenance:		
Slow down incremental buildup of C–31's		2,500,000
Limit acquisition of spare parts for fleet		700,000
Total		3,200,000

QUESTIONING BY SENATOR DE CONCINI

Senator Abdnor. Senator DeConcini, I skipped you on an opening statement.

Senator DeConcini. No, Mr. Chairman, I have no opening statement.

Senator Abdnor. Go right ahead, though. I will give you a chance to set it in there.

Senator DeConcini. Thank you very much. Mr. Commissioner, I want to applaud you on your recent statement of concern about the deteriorating situation regarding drugs and terrorism in the Southwest border. Our discussion yesterday was very helpful. It is no surprise to me that you and I share this same concern. I have certainly tried to beef up enforcement along the border and so has the distinguished chairman of this committee.

Last year the committee, and ultimately the President, did approve enhancement of 311 additional enforcement personnel along the Southwest border. Unfortunately, it appears that both the Gramm-Rudman-Hollings and the cuts contained in the President's fiscal 1987 budget probably have stalled the rapid deployment of those personnel to the border port of entries.

Can you tell the committee how many of these 311 slots for the Southwest border have been filled, and what the combination of Gramm-Rudman-Hollings and the gloomy President's budget has done to your commitment of resources to the Southwest border?

Mr. VON RAAB. Yes; the actual numbers for the Southwest border with respect to inspectors and agents are as follows. Let me just drop back to 1981 for inspectors. We had 683 inspectors that were assigned to the Southwest border. In 1982, we had 699. 1983, 717. 1984, 756. 1985, just about the time that we were talking about making these increases we had 783. Today we have 900.

As far as agents are concerned, in 1983 we had 144 agents on the Southwest border. Today, we have 170. Now, as you are well aware, the number of agents is occasionally confused by virtue of the conversion of some of our patrol officers to agents, but the actual increase in the numbers of agents from 1985 to today was from 151 to 170.

We are trying to put more people on the Southwest border.

Senator DECONCINI. With the President's budget and Gramm-Rudman, are you going to be able to continue to add any?

Mr. VON RAAB. No; we would not be able to add any personnel to the Southwest border.

Senator DECONCINI. More than what you have today?

Mr. VON RAAB. There are still a number of individuals that are being hired for the Southwest border, or in the process of being hired. It is not substantial, but as far as my authorizing additional hires for the Southwest border, I have no plans to do that under the present levels at which we are operating.

Senator DECONCINI. Two more questions along that line. Will you have to curtail any of those positions or lay anybody off?

Mr. VON RAAB. There may be some reduction of inspectors at the border, although this would be done only in our efforts to reduce some service at nonpeak hours. There would be no reduction in the number of personnel available to interdict drugs.

As I mentioned to Chairman Abdnor before you came, the passage of the Budget Reconciliation Act has caused us to review some of our plans concerning inspection and nonpeak hours and the reduction of service. It appears that there are some differences now in the funding practices that Customs will be required to employ because of this Budget Reconciliation Act. I basically think you will find that some of the possible reductions we are proposing or projecting for 1987 may not be as great because of the passage of the Budget Reconciliation Act.

I do not want to promise that right now because it is very complicated.

Senator DECONCINI. I understand.

Mr. VON RAAB. But I can assure you that if there is any relief provided through that act, we will apply those resources to the Southwest border. Our plans in Customs are now to turn our attention to the

Southwest border as the highest priority for all the reasons that I have stated publicly and in hearings because of the threat there. Wherever there is any possibility of generating additional resources, we will deploy them in the Southwest border.

Senator DECONCINI. Are you familiar with the urgent supplemental in the House?

Mr. VON RAAB. I have heard about it. I am not familiar with it although I understand that it put back in the Customs budget the Gramm-Rudman amount.

Senator DECONCINI. Obviously, that would be helpful to the Southwest border.

Mr. VON RAAB. We would take some of the resources, were that to happen, and put them in the Southwest border. There are other requirements in that bill that I believe would require us to put personnel in other places around the country. We are not entirely free under the terms of at least the bill as passed by the full committee to take all of those resources and put them in the Southwest border. I would sort of like to do that. But there are some other claims on some of those resources.

Senator DECONCINI. Commissioner, as I said, you have spoken out about the vulnerability of the Southwest border. I do not think anybody would ever question your loyalty to the President or to his budget in the job that you have to perform, bt you and I both agree on the danger that is there and has been for a long time.

We also have seen some good success in the Blue Lightning Operation in south Florida. Can you share with us for the record what you think might be done under these budget problems, or what might be done with additional funding—something similar to what you have done in the comprehensive area of south Florida?

Mr. VON RAAB. In south Florida, through a lot of hard work and genuine good intentions on the part of the Coast Guard and the Customs Service, we have crafted a very, very effective fighting force of State and local sheriff and police departments and Federal enforcement officers.

The glue that has pulled this together has been a spirit of goodwill that has developed between these two organizations and the State and local organizations. The catalyst for this spirit has been, for the most part, the loan of radios and some minimal equipment by the Federal Government to the State and local authorities. Whereas we used to have 22 separate police departments, sheriff's departments, as well as the Coast Guard and the Customs Service, we now have a strike force consisting of 24 agencies. Customs used to have 40 boats in Florida, but shortly we will have 80 boats. When you add to that the State and local resources that are pledged to this effort, we are going to have 168 boats.

We have gone from a situation of 24 organizations bumping into each other some years ago to 24 organizations that have pulled together. I would expect that the same sort of approach could be employed along the Southwest border.

Obviously, there are a lot of differences, but we have learned a lot, and we are continuing to learn a lot. I have personally contacted and will be meeting with the heads of the Immigration and Naturalization Service and the Drug Enforcement Administration, who are as concerned as I am about the problems in the Southwest border, to begin to craft another very serious effort along the Southwest border.

Obviously, we have all been working very hard, but I think it is time to bring our attention to bear again on the Southwest border, and bring it with a tremendous amount of energy, because the Southwest border is a horror story.

Senator DeConcini. It is, indeed, and thank you, Mr. Commissioner. I take it that there are obvious physical and personnel differences of the two geographic areas. Do you think that some kind of a massive coordinated effort can be put together.

Mr. von Raab. I am firmly convinced that is the only way to go. The Federal Government cannot do this alone. The Federal Government will not shirk its responsibility, but the people who are the most essential part of this are the State and local departments. They must have the backing of the Federal Government, and that is what we have in Florida.

Senator DeConcini. Let me ask you a question about the cattle-feeding industry in the State of Arizona, which has for some time been exploring the possibility of locating a slaughterhouse and packing facility strattling the United States and Mexican border near Yuma, AZ. In what appears to be a rather unique proposal, American cattle would be shipped to the site, slaughtered in Mexico, with the hides and remains left there, and the meat shipped back into the United States utilizing the Maquiladora, or duty-free zone process.

This twin-plant concept would help stimulate employment, both in Mexico and the United States. Back on March 17, I wrote and asked you to expedite a favorable Customs ruling on the applicability of U.S. Tariff Schedule, Article 807, or other TSUS schedules provisions that would allow this meat packing process to take place duty free. Can you give me and the committee an explanation of how these tariff schedules might apply to the Arizona meat packing project, and also give us some precedence for your argument both now and in more detail for the record, if necessary?

Mr. von Raab. Yes; first, let me assure you, if I have any discretion in this area, I will make a decision that will allow the Arizona Cattle Feeders Association to meet their goals.

Senator DeConcini. That is very helpful, and I appreciate that.

Mr. von Raab. I am sort of a farmer in my own right, and I have a few cows but nothing like Arizona. So I can sympathize with them. Our laws at times make this very difficult.

We are meeting with the Feeders Association this afternoon.

Senator DeConcini. This afternoon. I know you are.

Mr. von Raab. The preliminary reading is that this may be very difficult and may require legislation. I would like to do it, but it may be that the movement of the cattle into Mexico and the processing that takes place there may not meet the technical requirements of 807.

Senator DECONCINI. Who will make that determination?

Mr. VON RAAB. The lawyers initially will have to make the determination as to whether I have any discretion.

Senator DECONCINI. That is counsel with your——

Mr. VON RAAB. Yes; and if they tell me that I have discretion to make this, I will make a favorable ruling.

Senator DECONCINI. Have they made such a ruling or advice to you?

Mr. VON RAAB. No; because I think they are trying once again to figure out all of the facts that can be brought to bear, and my understanding is that the 2 o'clock meeting is designed to work this one more time to see if we can develop a factual basis for making this determination.

Senator DECONCINI. Mr. Commissioner, obviously you are charged with a duty, as I am, to follow the laws. If there is that discretion, and if your counsel can interpret that law to permit this, I think this is a real, real breakthrough for the cattle industry, and also that the Mexican Government is very anxious to have it. And we talked about problems with our two countries, and it may be a good indication that we are willing to advance commerce down there if they are willing to do some things on corruption and enforcement. So I do appreciate your meeting with them and doing everything you can.

If your counsel, you, or your office could advise me of the result of that, I would really appreciate it. I will have somebody there, but I would like to know what your ultimate result is. If I could yield to the chairman.

Senator ABDNOR. I just want to ask how would this work? I was not listening very carefully.

Senator DECONCINI. The cattle will be shipped—actually it will be more than just Arizona, down to Mexico to the border near Yuma. There would be a slaughterhouse built by the cattle producers in Mexico. Cattle would be slaughtered there nder USDA supervision and standards, the meat processed, and then shipped back into the United States, or wherever it might go, but probably most of it back into the United States.

Senator ABDNOR. It is the same American cattle?

Senator DECONCINI. Same American cattle. Cattle down there, slaughtered under our standards using some of their labor force to do it, and then sending the finished product back. Go ahead.I have some more questions, Mr. Chairman.

Senator ABDNOR. Yes; we can trade back.

Senator DECONCINI. Sure you go right ahead.

Senator ABDNOR. I have a lot of them, too. Customs is seeking some recisions, are you not?

Mr. VON RAAB. Yes; our budget is in two parts. In the salaries and expenses budget, the rescission is around $4 million, and in the air operations and maintenance budget, it is $19 million.

Senator ABDNOR. I think what this amounts to is the added dollars we put into the budget, were they not? What I am trying to say is that this was our initiative, the congressional initiative, where this money is coming out of?

Mr. VON RAAB. That is largely true in the air budget. Most of the reductions in the salaries and expenses budget are Gramm-Rudman reductions.

Senator ABDNOR. Tell me how are they going to be applied then.

Mr. VON RAAB. In the salaries and expenses budget, our rescission would be met through $1.5 million reduction for nonoperational funds designated for equipment and certain organized crime, drug enforcement, task force, and EXODUS activities. Some $1.3 million for the noncompletion of the procurement process on certain marine enhancements; $800,000 for a construction of a station on the Northern border, a joint Canada-United States station; $600,000 for the reduction of the payment of information and purchase of information fund.

On the air side, the rescission would be accounted for by the elimination of the Southwest aerostat for $9 million, the reduction of some of the equipment that would be put on the P–3 aircraft of $6.2 million, and other air reductions of approximately $4 million.

Senator ABDNOR. I guess that takes care of much of what we had added into the Southeast border. Another question then. I know you try, Commissioner, not to inconvenience importers and trappers, and you need to be commended for it, but what if you are going to have to do it now with less manpower? Are you going to start charging these guys users fees, as I understand it? They probably think they are going to get better service than they ever got before, and they are probably going to get less.

Do you think if we are going to start charging, we have a little bit of an obligation to do everything possible to give them the kind of service they are entitled to?

Mr. VON RAAB. There is a user fee provision contained in the Budget Reconciliation Act. I believe the way that will work is it should result in better service to the airlines who are most significantly affected by that.

Senator ABDNOR. Oh, you will put more people there and give them better service?

Mr. VON RAAB. I think it will be easier to manage the personnel under the system.

Senator ABDNOR. I asked Secretary Baker the other day, and I am going to ask you, Commissioner, are you proposing more automation so you can cut down on manpower?

Mr. VON RAAB. Yes.

Senator ABDNOR. Your manpower reductions are proposed for October 1, 1986. I think in the back of your statement you indicate your automation is at 20 percent today, could reach 50 percent by the end of 1986. Question: With reduced manpower and the automation not on the line, how does the work get done?

Mr. De Angelus. Senator, if I may, if you will look at our numbers, the Customs Service has remained essentially static in overall personnel resources over the past 10 years. In that period, imports, as you mentioned earlier, have grown substantially. Passengers traveling by land as well as by air have increased substantially, and Customs effectiveness has increased substantially.

We used to collect $8 billion a year. We now collect $14 or $15 billion a year. And at the same time, we have increased our enforcement resources while keeping overall Customs resources relatively static.

I think generally people agree that we have become more effective in the utilization of our resources, and one of the major ways is the utilization of automation and better selectivity methods in the way we process. We believe that as the automated system achieves these greater levels of interface with the trade community the personnel savings will accrue, and there will be no diminution of service.

Senator Abdnor. If you remember, I asked you what happened between that period of time when you get your automation on board, and the earlier period where you stop your numbers. How are you going to offset that? There is a gap.

Mr. De Angelus. I am sorry, Senator. You did ask that, and I did not address that directly. It is a problem to us, but it is a problem that exists throughout Government because you do not want to have a lot of unnecessary resources on board and then have to reduce staffing since it is very expensive to train staffing, and very costly to reduce staffing.

Senator Abdnor. You have them now, though, do you not?

Mr. De Angelus. We are making our savings through attrition, and we use highly selective systems in the meantime until we achieve the savings through automation. We do take shortcuts in the interim period, but we think in the long run everyone will be better off by doing that.

Senator Abdnor. I do not know. I believe you are going to have some problems. Something is going to have to give, either the kind of service, or lack of service.

Mr. De Angelus. Senator, if I may, you mentioned the user fees. We believe if Customs were left to its own management devices, without other restrictions put on, we could make more effective use of our personnel. The airlines quite often come in, and they were against user fees. However, one airline wants a separate terminal at JFK Airport. Two other airlines want a separate terminal at Los Angeles Airport.

Another airline wants a separate terminal at San Juan and a separate terminal at Dulles to process international passengers. I would submit that that is inefficient use of Customs manpower, and therefore, if it is more efficient for those airlines, and if it is in their interests for Customs to have separate processing facilities for them, then they should pay for the additional service that they want.

It is the same thing in the entry processing area and in other passenger processing areas. Customs has a fairly good record in processing passengers and cargo. If people, for good and valid economic reasons, in the commercial sector wish a higher level, a faster level of processing, then I think the user fee device is necessary so they can pay for an increased level of processing from which they will directly benefit.

Senator ABDNOR. What percent do they pay now? Anything?

Mr. DE ANGELUS. They pay nothing now. The taxpayers pay for it. However, there are only 10 million Americans who traveled last year. There were 34 million that arrived in the United States, but many people traveled the same times, and others were foreigners, and yet 237 million Americans paid taxes to finance the processing of those airline passengers.

Senator ABDNOR. Are you saying then that these people using the facilities should pay more one way or the other? I mean not the airline people. They are just performing the service. I mean we are saying to these people you cannot come in unless you are checked so maybe we better start putting a head charge on these people.

Mr. DE ANGELUS. That is what we are proposing, Senator, because we believe if the airlines want separate terminals so that they can capture the passengers to go from one of their flights to another of their flights rather than transferring to another airline, if they want to set limits of 45 minutes then——

Senator ABDNOR. Who are you going to charge, the airlines or the people?

Mr. DE ANGELUS. We are proposing to pass it on to the passenger at $2.50 per passenger.

Senator ABDNOR. OK. That will do it? That will give them a separate——

Mr. DE ANGELUS. That will cover all our expenses and allow us to add sufficient personnel to meet a 45-minute clearance standard from the time the airplane arrives till the last passenger is cleared.

Senator ABDNOR. That is going to take care of these extra sites then if these people are willing to pay this?

Mr. DE ANGELUS. It would not make good sense to charge people for a level of service which they believe is not meeting their needs. Therefore, we determined, based upon the needs of the various airports and seaports around the country, that we would need 700—this was in February of 1985—726 additional personnel.

We calculated the cost of those personnel in or enumeration of the user fee, for the proposed fee.

Mr. VON RAAB. Senator, let me give you an example that exists today with respect to user fees and application of resources. In my hearing before Congressman Roybal's committee, I was asked whether Customs would consider keeping one of the satellite terminals at LAX open. I pointed out that most of the traffic from this terminal had shifted into the main terminal, and where we used to process 1,200 passengers an hour, we were now processing 400. However, we have the same number of inspectors doing that. Quickly followed by a request from Congressman Coleman to increase the number of inspectors in El Paso. I agree the number of inspectors in El Paso is down. I said would you please speak to Congressman Roybal and get him to allow us to take those inspectors that are no longer fully employed at the terminal at satellite two to El Paso, or could we get the airlines in satellite two to pay for the fact that they have twice as many inspectors processing planes as they really need.

I think that points up the problem of the changing patterns of airlines. As you well know, airlines now are all very interested in moving to hubs. It is very important for international airlines to feed into a hub from which their domestic feeders move out.

This places tremendous pressure on Customs. It is our belief that since this hub concept is in the economic interests of the airlines, they should pay the additional cost to Customs for running traffic out of hubs instead of central terminals.

That is an example of what happens.

Senator ABDNOR. Senator DeConcini.

Senator DECONCINI. Thank you, Mr. Chairman. I have some questions on the user's fee, too, but I will just submit them, Mr. Commissioner.

Senator DECONCINI. Last year, Congress and the President approved funding for the installation of the large radar equipped aerostat balloon, as you will recall, in the system at Fort Huachuca, AZ. Now, the President has decided that he wants to rescind the money for the Arizona aerostat. Although you testified in Arizona that you were lukewarm—I think is a fair description of your feeling on the aerostat—I do commend you and your agency for moving ahead aggressively on the aerostat despite the proposed recision, and I say proposed.

Can you tell us when we can expect a contract award for the Arizona aerostat, when you would break ground, and when we could expect the aerostat to be flying?

Mr. VON RAAB. This is all on the assumption that the money is there, and the money is not. So I will violate my rules on answering hypothetical questions because of the great respect I have for you, Senator.

Senator DECONCINI. Let me just say I appreciate that immensely. But is it not technically—the money is still there; is that right?

Mr. VON RAAB. No; this money is gone. This money has been removed by a rescission action on the part of the Office of Management and Budget.

Senator DECONCINI. Is it not being withheld subject to the Congress acting?

Ms. KENT. Yes; that is correct.

Mr. VON RAAB. Then, we do not have it. It has been removed from our budget, but that may be correct. It is being withheld subject to congressional action.

Senator DECONCINI. OMB is withholding, I guess, from your budget until Congress says either we agree with OMB or we do not; is that a fair assessment, just for the record?

Mr. VON RAAB. Right.

Senator DECONCINI. Thank you. I appreciate the hypothetical answer.

Mr. VON RAAB. Just so you know what has been done. The RFP right now is in procurement and would be issued as soon as possible, assuming that the money would be there. The RFP would be issued in the second quarter of 1986. We would expect proposals in the third quarter of fiscal 1986. We would complete our evaluation in the third quarter of fiscal 1986. We would award the contract for site preparation, assuming an environmental impact statement is not required, in the fourth quarter of 1986, and would award a supplementary contract in the fourth quarter of 1986. We would expect a system delivery in the fourth quarter of 1987.

Senator DECONCINI. Fourth quarter of 1987?

Mr. VON RAAB. Yes; that is what I have.

Senator DECONCINI. It seems like an immense amount of time.

Mr. VON RAAB. We will take another look at it.

Senator DECONCINI. Thank you. Did it take that long, do you recall, to do the one in Florida?

Mr. ROSENBLATT. Yes.

Senator DECONCINI. In the Bahamas?

Mr. VON RAAB. I believe it did.

Mr. ROSENBLATT. Eighteen months.

Senator DECONCINI. I am just surprised that it takes such a long time.

Mr. VON RAAB. We will certainly do it as quickly as possible.

Senator DECONCINI. We are not dealing with a foreign government. We are dealing with a friendly army base and what have you. I am just kind of surprised at the time. I do not want you to fudge on that time, of course, but I am just surprised that it would take so long under the circumstances that look much more favorable, assuming that all the money is there. But if that is the way it is, that is the way it is. It just did not seem like that big of a job.

Mr. ROSENBLATT. Senator?

Senator DECONCINI. Yes, sir, Mr. Rosenblatt.

Mr. ROSENBLATT. If I might add, there is a certain amount of development that has to go into this particular aerostat and the appropriate radar system. That is the reason for——

Senator DECONCINI. For the time?

Mr. ROSENBLATT. Yes; the time, sir.

Senator DECONCINI. You mean it is not developed or put together, or is that what you are talking about?

Mr. ROSENBLATT. It is the software as well as the hardware that would have to be developed in conjunction with the RFP.

Senator DECONCINI. In other words, it is not on the shelf ready to go?

Mr. ROSENBLATT. No; that is correct, sir.

Senator DECONCINI. Was that true of the one in the Bahamas, too?

Mr. ROSENBLATT. Yes; that is correct.

Senator DECONCINI. Mr. Commissioner—my last question, Mr. Chairman. I will submit the balance of them. Yesterday the Senate antiterrorism caucus which I co-chair, held a hearing on suicide terrorism, and the threat of Libya, Iran, and Syria.

There is no question in experts' minds that these three countries pose a very real threat to the United States, and I am deeply concerned that Mexico would become vulnerable to these and other terrorist elements, transmitting through Mexico into the United States. Now, I understand that there is no direct evidence of any Mexican terrorist threat to the United States, but recent intelligence shows that terrorists from other countries may be probing the vulnerability of the United States-Mexican border for penetration into our country. Can you tell us what you can about the potential terrorist threat to the United States through the United States-Mexico border based on what intelligence you have, if it is not classified, and that of other law enforcement agencies?

Mr. VON RAAB. I would say that the statement as you presented it is correct. I do not have any recent specific intelligence which would cause me to believe that there are specific plans for terrorists to come across the border. I would only like to broaden the concept of terrorism, however, and say that the difference between a band of terrorists coming across the border with machine guns to me is indistinguishable from a band of drug smugglers coming across with 50 pounds of cocaine.

The damage that the terrorists could do with their machine guns in a shopping center in Tucson is probably less than the damage that terrorists with their 50 pounds of cocaine could do to that same population. So I guess the good news is that there is not any recent, specific evidence of which I am aware; but this is, as you know, a daily changing situation. So I would not rely upon that.

Senator DECONCINI. Is your point that the border is so vulnerable to drug traffic because of all the reasons you and I have talked about?

Mr. VON RAAB. If a terrorist wanted to come across the Mexican border——

Senator DECONCINI. That it would be easy for a terrorist to come across to commit a terrorist act; is that what you are saying?

Mr. VON RAAB. Absolutely. I mean look at the numbers of illegal aliens that come across.

Senator DECONCINI. Thank you, Mr. Chairman. I will submit the balance of my questions. Thank you, Commmissioner. Thank you, gentlemen and ladies.

Senator ABDNOR. Thank you, Senator DeConcini. Commissioner, you have proposed to streamline ports and district operations. How will this be implemented?

Mr. VON RAAB. That is the proposal that I have indicated would be effected by the provisions of the budget reconciliation bill. It was our first plan to go to a single shift at all airports. We have recently recommended to the Department that we not proceed with that plan because of the change in the way overtime is to be paid as a result of the reconciliation bill.

Previously, all overtime in airports was paid directly by the airlines to the Customs Service. However, with the signing of the bill, that will no longer be the case. Overtime in airports will be paid from a fund which is, in turn, funded by user fees. Our plans basically were to reduce the numbers of what are called WAE's, or when actually employed, on-call employees, and part-time employees at the borders and at the airports; reduce the number of inspectors where possible by putting them all on a single shift; and, using overtime rather than large numbers of personnel to staff the later hours.

But—and I am not trying to duck your question—but the passage of this bill has forced us to review that plan in order to avoid making management decisions that do not make sense.

I would say that our plans to streamline port operations are in abeyance until our analysts and lawyers have had an opportunity to review the provisions of the budget reconciliation bill to see how they affect these plans. I think they will probably change them significantly.

Senator ABDNOR. We may have some questions for you in writing for your views on this single shift versus others. We will get that added information in written form, if you do not mind.

Interior ports were fearful in recent years that they would be cut out of business with Customs changes. Is that any concern for you in 1987?

Mr. VON RAAB. I have heard that, and there have been statements thrown around that Customs is eliminating interior ports. With your permission I will after this hearing send you a copy of a white paper that we have written to explain what Customs is doing.

Customs is trying to reduce the burdens that we place upon importers in their inspections. Basically, we are going to try to clear more cargo as soon as possible without inspections, provided that we have sufficient information to assure ourselves that the cargo does not represent a risk, either in terms of contraband or in terms of loss of revenue.

Some people have felt that this might adversely affect interior ports. This might reduce some traffic to interior ports only on that merchandise that was previously shipped in bond. This would be a voluntary choice on the part of the importers and in no way is the Customs Service eliminating its in-bond system, or is it doing anything that would require interior ports to be eliminated.

We are turning to what we think is a freer market in the selection of transportation modes by the importers. I think, as with any change in practice, some interior ports will benefit, and others will be adversely affected; however, we do not expect that it will adversely affect the status of interior ports in the United States.

Senator ABDNOR. Do you suppose the statement on your intent will arrest a lot of the fears?

Mr. VON RAAB. Yes; we have been working very closely with a number of larger interior ports. One interior port, in particular, was concerned about this. In fact, on one day we had two delegations from that port, one which supported our proposals and the other which opposed them, allegedly representing the same city.

What that said to me was that there was certainly some confusion as to what we were doing. I think this confusion is the bigger problem rather than the actions we are taking. That is why we did prepare this white paper that sets forth our proposals more clearly, and I will send you a copy.

Senator Abdnor. You are going to send us a copy.

Mr. von Raab. Yes.

[The information follows:]

CUSTOMS PLANS FOR THE FUTURE A FREE MARKET IN TRANSPORTATION

Customs rules have in the past caused anomalies to occur in the natural flow of international commerce. Shipments of imported goods are required to be routed to specified ports for presentation of documents and physical examination, if necessary. Often the Customs ports of entry do not correspond to the actual destination of the cargo, and Customs processing results in additional transportation costs. Customs wishes to change this traditional way of doing business. In today's sophisticated trade environment, Customs does not wish to impose artificial transportation patterns upon the commercial sector. We wish to provide procedures and systems which allow the importer to obtain the earliest possible release of his goods from Customs custody in order that he may move the goods to whatever location he desires.

Customs is dedicated to the concept of the earliest possible release of low-risk shipments, and the reduction of paperwork through automation. Carriers, brokers, port authorities, importers, and Customs all have or are developing sophisticated automated systems. The Customs automated cargo selectivity system allows approximately 80 percent of shipments to be released without a complete physical examination. It is in the interest of both private and public entities involved in international trade to take full advantage of the opportunities offered by automation to develop innovative methods to improve upon the traditional processing of international shipments.

The development of the automated commercial system [ACS] by the Customs Service with its various modules such as the automated broker interface, automated manifest, in-bond, and cargo selectivity will enable the trade community to interface their automated systems with Customs. Automated brokers will be able to file entries electronically prior to the arrival of the ship or plane carrying the cargo. The entry information will be analyzed by ACS to determine if a physical examination is necessary. If no such examination is necessary, the broker will receive a return message informing him of this fact. Similarly, automated carriers will be able to transmit manifest information to Customs prior to the actual arrival of the vessel or aircraft. If a prefiled entry exists, it will be matched with the manifest; and if no examination is required, all parties concerned will be notified electronically that the shipment can be released upon arrival.

When no physical examination is required, Customs does not need to maintain physical control of the goods. This means that the goods should be able to move in the most efficient transportation mode and route as determined by the market free of Customs in-bond structure. Thus the supplying of advance and electronically transmitted entry data should result in the release into the normal, free market transportation system of over 80 percent of the goods that are now shipped in the archaic in-bond system. This should result in faster and cheaper shipment of goods into the interior of the country. This free market approach will result in a voluntary system which will provide the importing community and Customs with a practical alternative to the in-bond movement of goods. If no examination is required at the port of destination, it does not make sense to go through the costs, paperwork, and delays associated with the in-bond movement of goods. Importers have the right and will continue to have the right under statute to transport goods in-bond to any other port of entry that they desire. However, Customs believes that in most cases, they will prefer to release the goods at the first port of arrival if no examination is required.

Port of arrival immediate release and enforcement determination [PAIRED] is a first step in this direction that Customs wishes to go in the future. PAIRED allows the entry to be filed at one port for goods arriving at another port. The entry is processed through our ACS cargo selectivity system; and if no examination is required, the necessary release information is transmitted to the port of arrival. High-risk shipments requiring examination for potential contraband or other serious violations will be examined at the port of arrival. Shipments requiring regulatory compliance examinations will be allowed to move in-bond to the port of destination unless the importer (or broker) agrees to have the examination conducted at the port of arrival.

The current in-bond system was designed to deal with the nonautomated commercial environment of the past. It made perfect business and Customs sense to transport imported cargo closest to the importer where entry could be made and the cargo examined and released. In those days, brokers usually were local and licensed to practice only in one district. In addition, the lack of selectivity procedures required Customs to examine each shipment, and transportation in-bond to less congested ports resulted in a speedier release of cargo. Another factor was the minimal problems associated with in-bond shipments since drug trafficking, quota and trademark violations, pornography, et cetera were limited in scope. Therefore, the in-bond system met the needs of both Customs and the trade community.

We believe that the importing community will agree with us that the free market approach is the way of the future and that PAIRED is a step in this, the right direction. It is a concept which will prove itself in the commercial environment. If it allows the importer to receive his shipment quicker and at less cost, it will be widely used. If not, it will soon be evident that PAIRED does not conform to the commercial realities. Customs is working to develop more efficient and less costly ways to control and process imported shipments. It is our opinion that low-risk shipments should be released as soon as possible. PAIRED was designed to facilitate early release and to reduce our processing costs and hopefully those of the importer and carrier.

PROHIBITION LANGUAGE

Senator ABDNOR. What happens to Customs if Congress appropriates the exact dollar figure you are requesting, but also includes the prohibition language that the House has insisted on for the last 10 years.

Mr. VON RAAB. You mean in terms of the management actions that we can take?

Senator ABDNOR. Yes.

Mr. VON RAAB. We would be forced to take——

Senator ABDNOR. Closures.

Mr. VON RAAB. Right. That would be a disaster. We would be forced to take cuts in areas that would affect drug interdiction, areas that would affect EXODUS, and areas that would affect textiles. If our budget was implemented, with prohibitions against taking reductions in areas we have proposed, we would be forced to take reductions in other areas. That would be a disaster.

Senator ABDNOR. Did you let them know that on the other side, too?

Mr. VON RAAB. They did not ask me the question, but it would be a terrible thing if that happened.

Senator ABDNOR. The budget resolution reported recently from the Senate Budget Committee freezes Customs at the $686 million level for the next 3 years. Do you have any observations on how this will impact Customs? I do not know if you have taken a look at that budget resolution, but that is the most recent one.

Mr. VON RAAB. I have not looked at that, no.

Senator ABDNOR. That is what it calls for, a cap on Customs. I wish you would give us your views on this in writing. I would appreciate it if you would just take a look when you get a chance.

Mr. VON RAAB. Yes; we certainly will, and we will get with your staff and explain to them how we would see that this would affect us.

ADDITIONAL COMMITTEE QUESTIONS

Senator **Abdnor**. Yes; that would have quite an effect, I would think. We have other questions, and I am sure you know we will be submitting them in writing as will Senator DeConcini, and anyone else on the committee. So with that, we will just conclude our hearing.

I appreciate your attendance, and being so willing to cooperate here on questions. We ask alot of them, I know.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Additional Committee Questions

COMMAND AND CONTROL INTELLIGENCE CENTERS - EAST AND WEST (C3I)

Senator DeConcini: What would it take to establish an East and West C3I capability at Miami and Tucson in Fiscal 1987 and how quickly could we see such capability on-line?

Commissioner von Raab: We currently are planning the establishment of the Command, Control, Communications and Intelligence (C3I) centers. Initially, several firms were selected competively in fiscal 1986 to provide "core" system designs by mid-fiscal 1987. A final determination of the most appropriate C3I sites will be made by this time. A contractor will then be chosen to implement the selected design. We will also acquire the services of an Architect-Engineer in FY 1986 to design the actual C3I Center facilities. Our estimate is that a core C3I capability could be available approximately 6 months after a contractor is directed to proceed; i.e., by late FY 1987.

Senator DeConcini: What will be the effect on Operation EXODUS efforts if you receive no relief from Gramm-Rudman and the President's FY 1987 budget? (If there will be little if any effect, how will you maintain this program with such a huge cut in inspectors?)

Commissioner Von Raab: Gramm-Rudman reductions will impact the Operation EXODUS program to some degree. However, in FY 1987, a variety of enforcement initiatives will be implemented to increase the quality and improve the overall effectiveness of our investigations, such as additional undercover operations and increased intelligence capabilities.

EXODUS is vital to this country's national security, and this view is shared throughout the Administration, particularly the Defense Department. The intelligence community considers EXODUS to be a priority program and we are receiving excellent support from them; it is also receiving strong support from the business community. We have made a major effort to ensure that legitimate exports are not unnecessarily delayed with a sophisticated targeting and selectivity program in operation at the major ports. Through FY 1985, in excess of 80 percent of the merchandise detentions resulted in seizures -- meaning that we are successfully targeting the illegal exports. We also conduct Operation GEMINI designed to enlist the support of the manufacturing and exporting community for EXODUS objectives. Many of our significant investigations involve a great deal of voluntary industry support, and many of our investigations have been initiated based on information on potential violations volunteered by the business community.

PERSONNEL CUTS: THE EFFECT ON COMMERCIAL OPERATIONS

Senator De Concini: Can you tell us how you intend to maintain an aggressive effective commercial/revenue collection operation in light of these cuts? Be specific.

Commissioner Von Raab: We are aggressively pursuing new procedures that have resulted in substantial savings in staffing and will enable us to process an increasing workload with a much reduced staff. Some of these new procedures are:

- Development of the Automated Commercial System (ACS) to provide increased labor saving procedures. For example, with the use of the Daily Statement, hundreds of collections can be processed with just one transaction.

- Shift of data input responsibilities from Customs to brokerage firms as a result of the Automated Broker Interface.

- Introduction of selectivity concepts to cargo processing, both in examinations and entry summary reviews. Selectivity has resulted in substantial savings in import specialist and inspector manhours.

- Consolidation of districts and duty assessment locations to eliminate duplication, reduce overhead, increase uniformity, increase quality of service, and take advantage of economies of scale.

- Allocation of import specialist and classification and value personnel to place resources in accordance with the location and existence of workload.

Senator DeConcini: Why the disproportionate annual fee for aircraft owners and what effect do you feel this fee could have on the general aviation industry?

Commissioner von Raab: The user fees listed in the "working draft" schedule are not final and are still subject to revision as more detailed data becomes available. User fees are based on Customs actual costs for providing a specific service to the private aircraft owner. The variance noted in total collections for this user fee results from differences in the estimated number of aircraft involved in crossing the border. We are analyzing these figures to insure that the estimated collections are accurate.

The fee for aircraft owners represents, as I indicated, the estimated costs for inspectional services and it is consistent with other fees. Furthermore, the fee includes the overtime charges usually assessed to private aircraft owners when arriving outside normal duty hours. Under these circumstances, the proposed user fee does not impose an onerous burden on the private aircraft owner.

DRUG INTERDICTION: ADMINISTRATION ABANDONING INTERDICTION?

Senator DeConcini: There is no question in my mind that this Administration has placed the "interdiction" side of our war on drugs on the back burner and opted instead to concentrate on the "investigative" element of the equation. Despite Administration claims, Coast Guard and Customs--our two drug "interdiction" agencies--have constantly been cut back by the President. Fortunately, the Congress has kept both agencies going with budget increases over Administration objections time and time again.

Isn't it fair to say that at the very least, OMB has taken the position that interdiction has failed to halt drug smuggling and should therefore be abandoned and replaced with long term efforts to reduce supply, and investigations of drug trafficking organizations?

Commissioner von Raab: I believe that the Administration, as well as OMB, remain fully committed to the war against drugs. However, there is current discussion within the Administration on the most effective use of limited resources to achieve maximum results against illegal drug activity. Re-evaluation of current drug enforcement programs government-wide and the results being achieved will provide valuable information toward controlling and gaining on the war against drugs, while exercising fiscal restraint in the face of large Federal deficits.

Senator DeConcini: Don't you feel that abandonment of a comprehensive drug "interdiction" plan would be a sellout to the drug traffickers and other criminal elements who are threatening our southwest border?

Commissioner von Raab: Customs drug interdiction efforts will continue at their current levels along the southwest border.

SUPPLEMENTAL APPROPRIATION BILL: RESTORATION OF CUSTOMS FUNDING

Senator DeConcini: Commissioner, as you know, the House Appropriations Committee has recommended restoration of your Gramm-Rudman March 1st sequester cut for both the Air Program and your Salaries and Expenses account. The total restoration of funds would be about $34 million. The House has also set a personnel "floor" for Customs at 14,041 positions and directed you to put positions into the priority areas outlined in the House, Senate, and Conference reports of last year?

If this supplemental is ultimately approved by the President (not likely), what specific things will you be able to do between now and the end of the current fiscal year? Be specific and tell us what assets we might expect to be put into the southwest border.

Commissioner von Raab: If Gramm-Rudman reductions are restored to Customs in FY 1986, Customs will review current operations and return funds and staffing to high priority areas. Any decisions will also depend on the amount of time remaining in the fiscal year after the supplemental has been approved and the degree to which any of the previously implemented reductions have impacted operations. However, the southwest border will be one of the high priority areas assigned any additional funds.

Mr. DeConcini: You indicate that you will be able to save nearly $10 million next year by so-called 'selective hiring' that will allow only those vacanacies determined to be critical or essential to be filled. I presume that you will be focusing attention on hiring law enforcement personnel rather than filling other Customs needs on the commercial side.

What specific programs, projects, and activities will be "the big losers" under your selective hiring policy in FY 1987? Be specific and provide details for the record.

Mr. von Raab: No one program or project has been specifically identified by this management initiative. The selective hiring policy will be based on strengthening Customs position management. As vacancies occur throughout the year they will be closely scrutinized by management to determine whether it is deemed critical or essential to fill the vacant position. Since there is no way to determine precisely where vacancies will be occurring, we cannot be more specific as to what programs or projects will be hit the hardest.

However, I would like to reiterate that Customs policy is to minimize any impact upon the operational and enforcement capabilities of Customs field units. Wherever possible, the cutbacks will be imposed so that revenue collections, passenger, vehicle, and cargo processing are not significantly affected. On the enforcement side, Customs intends to keep the Air, Marine, and Investigative programs as fully staffed as possible.

CUSTOMS HIGH ENDURANCE TRACKER AIRCRAFT (CHET)

Senator DeConcini: Could you tell us briefly what the latest progress report is on the CHET procurement and when we can expect to have these trackers up and flying after drug smugglers?

Commissioner von Raab: As of March 31 the FAA has issued a type certificate for the CHET. The first aircraft is now planned for delivery to USCS in April 1986 for Customs acceptance flights. All eight CHETs are planned to be delivered by July 1986. Pilot, sensor systems operator and maintenance training have been proceeding on schedule. Customs delivery rate will be approximately one CHET every 2 weeks after acceptance. A structured operational evaluation (OPEVAL) will be conducted immediately after full acceptance by the Customs Service of the first CHET aircraft. Targets of opportunity encountered during the OPEVAL will be pursued. Essentially, the CHET aircraft will be operational for interdiction activities upon full acceptance by Customs.

COOPERATION WITH THE BAHAMAS: OPERATION BAT

Senator DeConcini: What are the prospects of putting Bahamians on your planes to allow you to chase smugglers into the Bahamas? What other joint cooperative efforts are underway with the Bahamians to address the continuing Bahamian role in drug trafficking?

Commissioner von Raab: Response time and coordination from BAT has increased greatly since February 1986 when DEA replaced their short range UH-N1 helicopters with two Black Hawk helicopters equipped with long range fuel tanks and the establishment of a helicopter pad in Georgetown.

Customs is very receptive to having Bahamian officials flying in our aircraft. This would give Customs the capability of pursuing airborne smugglers into the Bahamas. The following guidelines would have to be followed:

- If Customs aircraft followed a suspect into the Bahamas, Customs personnel would not take any enforcement action unless it was a life threatening situation.
- All enforcement actions would be handled by the Bahamian officials onboard.
- Approval from the State Department and the Bahamian Government must be granted before this effort could be initiated.

Customs is pursuing acquisition of additional intelligence and increased coordination with the existing "BAT" resources.

VOICE PRIVACY CAPABILITY AT CUSTOMS

Senator Deconcini: Commissioner, what would it take to bring Customs up to speed in Voice Privacy, if we begin in fiscal year 1987 and have 100% capability by 1989? Give us an estimate now and provide details for the record.

Commissioner von Raab: Although Customs already has implemented Voice Privacy in several locations, we estimate an additional $24 million for equipment and installation is required to meet all enforcement requirements. In addition, Customs has been implementing a modern and private HF/SSB system to support its Air and Marine programs. To expand this system to cover the southern border and both coasts, we estimate an additional $7 million will be needed.

P-3 STATUS

Senator DeConcini: Are you totally geared up now to fly; crew; operate and maintain the current fleet of Customs P-3s and if not, why not?

Commissioner von Raab: As you are aware Senator, we have encountered significant problems in recruiting experienced and eligible pilots and other technical staff required to fly and operate the P-3 aircraft. Despite these problems, all of which are now virtually overcome, Customs is operating all four P-3 aircraft on operational missions from Tucson, Arizona, and New Orleans, Louisiana. At this time, we have sufficient staff onboard and in training to operate all four P-3A aircraft a minimum of 100 hrs./ month basis. We intend to maintain a vigorous recruiting effort to ensure that there are no staffing shortages in the future.

P-3A SENSOR IMPROVEMENTS: COMINT: ILS: ELECTRO-OPTICS

Senator DeConcini: What is the status of these P-3A aircraft systems? Be specific.

Commissioner von Raab: We are completing procurement actions required for the acquisition of the COMINT systems and the mission commander's system integration consoles funded by the FY 1985 supplemental appropriation. We expect to have contracts in place during the fourth quarter of fiscal 1986 for both of these components. We have carefully examined the capabilities of available electro-optics systems and have reached the conclusion that developing one that would provide meaningful assistance to our drug interdiction program would place Customs in the risky and expensive positions of advancing the electro-optics state-of-the-art. We believe that this research should be performed by others, and that these funds could be better used to provide COMINT systems for our P-3A aircraft.

C-12 STATUS

Senator DeConcini: What is the status of the C-12 Program? What is Army's latest estimate of when you will get your aircraft? What are your plans for those planes?

Commissioner von Raab: The C-12 Program is progressing on schedule. The U.S. Army is planning to transfer the first C-12 to the U.S. Customs Service during September 1986. The aircraft modification proposal is presently being prepared and will be awarded prior to the arrival of the U.S. Army C-12. The current plans for the C-12s are for them to be dedicated marine support aircraft and based such that this support will be maximized.

Senator DeConcini: If you do realize this level of additional revenue from the Reconciliation Bill, what would you do with the money? Tell us briefly now and provide as much detail as possible for the record.

I would strongly urge you to put those resources into increased law enforcement on the southwest border.

Commissioner von Raab: Customs does intend, in the short term, if it becomes available, to use the additional funds to improve the effectiveness of its enforcement programs, especially along the southwest border and at other priority smuggling locations. In general, Customs will allocate required resources to strenghten its capabilities at the ports along the southwest border where we have identified significant increases in cocaine and heroin smuggling.

Additional inspectors, canine enforcement officers, contraband enforcement teams, and investigative officers will be allocated to this area. In addition, the air and marine programs will be allocated the required resources to support the interdiction effort along this border as well as other critical smuggling areas.

Mr. DeConcini: Commissioner, your original request for salaries and expenses to OMB back in September of 1985 called for $753.5 million and 13,835 positions compared to the President's final budget request of $693 million and 12,677 positions.

Your September air program request to OMB was $71.4 million compared to their final recommendation of $54.7 million.

What specific activities and programs would you have been able to conduct under your original S&E request and your original Air Program request to OMB? Tell us four or five things you would have been able to do under your original budget request and give us more details for the record.

Mr. von Raab: The Customs Service originally requested enhanced levels for our detection, interdiction, and commercial fraud enforcement programs. This required additional resources, both manpower and dollars, to expand the hours of operation at several air modules, facilitate the incremental development of the command, control, communication and intelligence centers (C3I's), and increase enforcement efforts against steel, textile, counterfeit products, and other major frauds. These initiatives would have enhanced our overall enforcement capability and provided additional deterrents to criminal elements.

Senator DeConcini: You indicate in your justifications that you will be able to save 235 positions and $7.7 million from streamlining district and port operations.

How many ports will you close or consolidate and what specific steps are you planning to take to streamline your district operations? Give us your complete list of proposed closings; consolidations; or reductions in-hours-of-operations for the record.

Commissioner von Raab: The Customs Service will not be closing any ports, although we are still planning to consolidate appraisement centers. After the consolidation there will be 29 appraisement centers. In addition, Customs must reduce the hours of operation at certain northern border ports; however, at this time we have not identified the specific northern border ports.

Listed below are the appraisement centers after consolidation:

1. Boston, MA
2. Ogdensburg, NY
   Champlain
3. Buffalo, NY
4. Philadelphia, PA
5. Baltimore, MD
6. New York, NY
7. JFK, NY
8. San Juan, PR
9. Virgin Islands, VI
10. Miami, FL
11. New Orleans, LA
12. Laredo, TX
13. Nogales, AZ
14. San Diego, CA
15. Los Angeles, CA
16. San Francisco, CA
17. Seattle, WA
18. Honolulu, HI
19. Pembina, ND
20. Detroit, MI
21. Chicago, IL
22. Cleveland, OH
23. Dallas, TX
24. Tampa, FL
25. Charleston, SC
26. El Paso, TX
27. Norfolk, VA
28. Houston, TX
29. Minneapolis, MN

Questions Submitted by Senator Mack Mattingly

Senator Mattingly: I understand that the Customs Service, just like all other government agencies, is having to tighten its belt. One of the management initiatives you are incorporating is, what you are calling "Single Shifts at Airports". Would you please elaborate on that concept, such as what it consists of, what airports will be affected, what effects (both positive and negative) it will have on Customs operations, and what impact it might have on airports that have recently expanded their workforces?

Commissioner von Raab: In response to Gramm-Rudman reductions in FY 1986 Customs was considering the implementation of single shift schedules at airports in order to reduce expenses. However, this initiative is no longer a viable option for Customs consideration in FY 1986.

Senator Mattingly: Along that line, I am holding a copy of a letter from the Commissioner of Aviation at Hartsfield International Airport, dated March 19, 1986, and addressed to you, concerning the Customs decision to place on inactive status 25 part-time personnel there. Now, I know you and I have talked about this matter before. However, Commissioner Carter brings up an important point that I would like for you to address.

I cannot verify the figures that he uses in the letter, but he said this reduction has more than doubled inspection time from an average of 40 minutes per international flight to as much as one hour and 35 minutes.

Now, I think you would agree that, if this is the case, it is totally unacceptable. Does your office have any figures concerning this, and what actions would you take if these reductions were causing such delays?

Commissioner von Raab: Both the U.S. Customs Service and the Immigration and Naturalization Service have had funding difficulties in filling positions at Hartsfield Atlanta International Airport. Our appropriation cannot cover all the additional personnel required, nor can we retain all the full-time, part-time and intermittent Customs employees at Atlanta.

For the time being, the Atlanta Port Director of Customs is able to avoid reducing his full-time and regularly scheduled part-time staff. However, he must virtually cease calling out intermittent inspectors to supplement his staff during peak passenger arrival times.

The Port Director measured passenger processing times with and without intermittent inspectors. Over a one-week period with the intermittents, 45 flights arrived and averaged 30 minutes from first baggage arrival to the last person exiting the facility. On a subsequent week without intermittents, 43 flights averaged 32 minutes.

AUTOMATED COMMERCIAL SYSTEM CARGO SELECTIVITY

Senator Mattingly: You mentioned that, in the area of cargo processing at major ports, Customs is planning to expand the Automated Commercial System Cargo Selectivity. Could you elaborate on this expansion and tell the subcommittee how many additional sites are expected to be implemented in 1987?

Commissioner Von Raab: To date, the Automated Commercial System Cargo Selectivity module is operational at some 47 locations nationwide. These locations account for approximately 50 percent of the national volume.

The following represent those locations targeted for implementation. When such implementation is effected, better than 90 percent of the national volume will be processed through the cargo selectivity module.

Location	Target Implementation
New York Seaport	July 1986
JFK Airport (New York)	1st quarter, FY 87
Newark	1st quarter, FY 87
LAX International (Los Angeles)	1st quarter, FY 87
Champlain	FY 87
Buffalo	FY 87

Location	Target Implementation
Detroit	FY 87
Port Huron	FY 87
Saulte Ste. Marie (Michigan)	FY 87
Pembina (North Dakota)	FY 87
Sweetgrass (Montana)	FY 87

Senator Mattingly: I have a couple of questions concerning your testimony. In it you state that, because of budget constraints, you will be required to make some hard choices and that funds will not be sufficient to achieve all of your goals related to controlling drug smuggling. Could you tell us which of your goals you intend to pursue, that is, which ones will take priority?

Also, in what ways can we assist you in reaching your goals?

Commissioner von Raab: Customs high priority efforts to reduce the flow of illicit narcotics into the country will continue despite tight budget constraints. To aid in this effort, Customs will continue to improve and increase its narcotics intelligence, selectivity and automation capabilities to enhance the investigative and intelligence aspects of our drug interdiction program. Within the Air Program, Customs will support continued full operations of all Customs air units currently available. We will also increase our use of detection aircraft and high endurance tracker aircraft in FY 1986. In addition, Customs marine program, which has grown into an effective force against drug smuggling by sea, will continue successful strategic operations in high threat locations.

In addition to illegal narcotics trafficking which has been a continuing and pervasive problem, Customs will give priority to the development of its Automated Commercial System (ACS) and to improve enforcement against the growing commercial fraud problem. We have received the support and cooperation of state and local authorities, as well as foreign countries in our drug enforcement efforts. These efforts have yielded successful short term results and promising long term effects. We also recognize and appreciate the support Congress has given to not only Customs drug interdiction program, but also its program for moving to automated systems and its Commercial Fraud Program.

DRUGS

Senator Mattingly: Commissioner, I want to congratulate you on the new records the Customs Service has achieved in heroin and cocaine seizures. I wondered, however, if you could put these accomplishments in context? Are we in fact gaining ground against the smugglers or are the larger seizures simply reflective of much larger shipments into the United States? Is more cocaine reaching our streets?

Commissioner von Raab: It is difficult to provide you with a precise estimate of the extent of heroin and cocaine smuggling and of the trend towards larger shipments of these drugs. According to our seizure statistics, there are mixed trends depending upon the specific drug under consideration. For cocaine, 9 of the top ten seizures have been made within the past two years which indicates a trend toward larger shipments. The question, as to whether our enforcement efforts are successful, will be answered over the next year. If only smaller shipments are seized, then we can presume that the risk has increased sufficiently to force the smugglers to shift to smaller shipments.

By comparison for hashish and marijuana, only one of the top ten seizures was made within the past two years. While it appears that the Customs Service and other federal agency seizures forced the shift to less risky smaller loads, there are also indications that demand for these drugs also has declined.

Similarly, only three of the top heroin seizures were within the past two years. The biggest seizure, made in June 1985 in Seattle, involved a group of Thai-based ethnic Chinese who had been making frequent trips to locations in the United States with metal covered items as accompanied baggage. The seizure was made in a shipment of ice buckets purportedly for sale to Chinese restaurants.

Lastly, all indications are that more cocaine is reaching our streets. While large seizures in Colombia, on the high seas, and at Customs ports-of-entry should have had an effect, there is no question that a massive amount of cocaine is still crossing our borders from in-pipeline and stored amounts.

PORNOGRAPHY

Senator Mattingly: You stated that Customs has stepped up the level of enforcement in pornography trafficking. As you know, my colleague, Senator Trible and I have introduced legislation (S.1742) which would allow the Customs Service the option of forwarding seized material to the federal judicial district in which the addressee resides rather than requiring it be forwarded to the U.S. Attorney in the district in which it was seized. Do you believe this will strengthen our effectiveness in curbing the importation of pornographic material and in seeking prosecution of violators of the law?

Commissioner von Raab: Yes, I do. As you are aware, existing law requires the government to institute forfeiture proceedings against obscene articles in the district where such articles are seized by the U.S. Customs Service. We believe the bill (S.1742) which would give the government the option of transferring the venue of the forfeiture proceedings to the district in which the named addressee resides, would for several reasons strengthen our enforcement efforts.

First, given the fact that Customs searches are concentrated at principal ports of entry, permitting the initiation of forfeiture proceedings in the addressee's district will ease the burden currently placed on the offices of the United States Attorneys in those few districts. Of course, this would also distribute more equitably the resources of the Customs Service which are devoted to curbing the importation of pornographic materials.

Second, we believe the government could achieve both a higher success rate of judicial forfeitures as well as bring forfeiture decisions into conformity with more appropriate community standards. In other words, the bill would allow Greensboro, North Carolina to decide whether materials destined for its community are obscene under its own community standards, instead of allowing New York City community standards to be the applicable measure.

The U.S. Customs Service has a consistent record of vigorously enforcing the laws which are designed to combat the introduction of this material into our country. I believe the subject legislation will enhance our enforcement efforts in this area by resolving problems of administration under current law.

TEXTILE IMPORTS

Senator Mattingly: Commissioner von Raab, for several years now I have worked with the Customs Service in an effort to eliminate fraudulent imports of textile and apparel products. I helped author legislation, now law, that requires such products to be labeled as to country of origin. I have supported U.S. Customs Service policies designed to strengthen inspection procedures of shipments of these goods. However, those nations intent on gaining illegal entry to the U.S. textile and apparel market continue to seek "innovative" ways to circumvent U.S. quotas. Previously textile and apparel shipments valued at less than $250 were exempt from Customs inspection. Traditionally such small shipments contained nothing more than samples and provided a useful marketing tool for retailers. Today, however, this exemption is providing an increasingly useful tool for illegal imports. Commissioner von Raab, Customs, at the last minute, decided to delay implementation of revised rules to allow for inspection of shipments valued at less than $250. Can you tell us the status of this revision and your reasons for delay?

Commissioner von Raab: After the issuance of the Directive, it became apparent that there would be enormous practical difficulties in instituting the changes on as ambitious a schedule as originally anticipated. As a result, Treasury's Office of Enforcement and Operations and the Customs Service determined that this new program would be best served by extending the effective date to allow for planning and preparation both by affected importers and by the Customs Service. The revised effective date, namely March 9 was cited in our Directive 3500-07, dated February 28, 1986. This date was set after considering Customs' needs and the likelihood that too rapid an implementation would cause hardship on importers, brokers and retailers in disrupting routine shipping arrangements that were made in reliance on longstanding practice. However, we instructed our inspectors and import specialists to be alert, during the period prior to the new effective date, to significant increases in the number of textile and apparel shipments attempted to be entered under the informal entry procedure. If a surge in such entries had been detected, we would have taken appropriate enforcement action immediately.

SUBCOMMITTEE RECESS

Senator Abdnor. I want to thank Mr. Queen and Commissioner von Raab for their participation. If there is no further business to come before the subcommittee, we will stand in recess until 2 p.m. on Wednesday, April 9, when we will review the budget of the Office of Personnel Management and the Federal Elections Commission.

[Whereupon, at 11:45 a.m., Thursday, March 27, the subcommittee was recessed, to reconvene at 2 p.m., Wednesday, April 9.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

WEDNESDAY, APRIL 9, 1986

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–124, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, and DeConcini.

OFFICE OF PERSONNEL MANAGEMENT

STATEMENT OF CONSTANCE HORNER, DIRECTOR

ACCOMPANIED BY:

- JAMES W. MORRISON, JR., ASSOCIATE DIRECTOR FOR COMPENSATION
- THOMAS J. SIMON, ASSOCIATE DIRECTOR FOR ADMINISTRATION
- FRANK D. TITUS, ASSISTANT DIRECTOR FOR FINANCIAL CONTROL AND MANAGEMENT
- JOHN PREBIS, ASSISTANT DIRECTOR FOR BUDGET AND MANAGEMENT
- SIDNEY M. CONLEY, CHIEF OF THE BUDGET DIVISION

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order and today we continue our fiscal year 1987 budget review. We will receive testimony from Ms. Constance Horner, Director of the Office of Personnel Management, and John McGarry, the Vice Chairman of the Federal Election Commission.

I do not have an opening statement. Do you?

Senator DECONCINI. I have no opening statement, Mr. Chairman.

Senator MATTINGLY. I have none.

Senator ABDNOR. Well, good. We can proceed.

Ms. Horner, it is good to have you here. And why do you not introduce your colleagues and proceed.

Ms. HORNER. Thank you very much, Mr. Chairman.

INTRODUCTION OF ASSOCIATES

This is my first opportunity to appear before the committee, and I look forward to working with you and the members of the committee in the future.

Senator ABDNOR. Thank you.

Ms. HORNER. I have with me today Mr. James Morrison, Associate Director for Compensation; Mr. Thomas Simon, Associate Director for Administration, and their staff members.

I would like to summarize, if I may, and submit my testimony.

Senator ABDNOR. That will be fine.

PREPARED STATEMENT

Let me tell you, since it is your first appearance, your entire statement will be made a part of the record.

Ms. HORNER. All right.

Senator ABDNOR. And you can summarize or do whatever you care. And we certainly welcome everyone who is appearing.

Thank you.

[The statement follows:]

STATEMENT OF CONSTANCE HORNER

THANK YOU FOR INVITING ME TO APPEAR TODAY TO DISCUSS THE PRESIDENT'S REQUEST FOR APPROPRIATIONS FOR THE OFFICE OF PERSONNEL MANAGEMENT FOR FISCAL YEAR 1987.

I AM ACCOMPANIED THIS AFTERNOON BY SEVERAL MEMBERS OF OPM'S STAFF. THEY ARE: MR. JAMES W. MORRISON, JR,. ASSOCIATE DIRECTOR FOR COMPENSATION; MR. THOMAS J. SIMON, ASSOCIATE DIRECTOR FOR ADMINISTRATION; MR. FRANK D. TITUS, ASSISTANT DIRECTOR FOR FINANCIAL CONTROL AND MANAGEMENT; MR. JOHN PREBIS, ASSISTANT DIRECTOR FOR BUDGET AND MANAGEMENT; AND MR. SIDNEY M. CONLEY, CHIEF OF THE BUDGET DIVISION.

IF I MAY, I WOULD LIKE TO BEGIN WITH A BRIEF REVIEW OF THE ADMINISTRATION'S MAJOR BUDGET PROPOSALS CONCERNING FEDERAL PERSONNEL MANAGEMENT, AND THEN TURN TO THE PROPOSALS FOR OPM'S OWN BUDGET.

ONCE AGAIN THIS YEAR, WE ARE CALLING FOR A MAJOR REFORM OF THE CIVIL SERVICE RETIREMENT SYSTEM. WHILE THERE HAS BEEN MUCH HEATED ARGUMENT OVER THE RETIREMENT SYSTEM IN RECENT YEARS, THE SIMPLE, UNDISPUTED FACT IS THAT THE CURRENT RETIREMENT SYSTEM IS FAR MORE COSTLY THAN PRIVATE SECTOR PENSION PLANS, AND PROVIDES BENEFITS THAT SIGNIFICANTLY EXCEED THOSE IN THE PRIVATE SECTOR. THE SYSTEM'S HIGH COST HAS FRIGHTENING LONG-TERM IMPLICATIONS: THE TRUE UNFUNDED LIABILITY, UNDER ASSUMPTIONS THAT INCLUDE THE IMPACT OF PAY INCREASES AND INFLATION, EXCEEDS ONE-HALF TRILLION DOLLARS. EVEN THE STATIC UNFUNDED LIABILITY--WHICH IS UNREALISTIC BECAUSE IT DOES NOT TAKE INTO ACCOUNT INFLATION OR SALARY INCREASES--IS ESTIMATED TO BE $191 BILLION.

TO DEAL WITH THIS MOST SERIOUS PROBLEM, WE ARE PROPOSING SEVERAL CHANGES THAT WILL INCREASE REVENUES TO THE SYSTEM AND DECREASE ITS OUTLAYS. WE ARE PROPOSING THAT EMPLOYEE AND AGENCY CONTRIBUTIONS TO THE SYSTEM BE INCREASED FROM 7 PERCENT TO 9 PERCENT. ON THE BENEFIT SIDE, WE ARE PROPOSING A PENALTY FOR THOSE WHO RETIRE BEFORE AGE 62 AND A LIMIT ON COST-OF-LIVING ADJUSTMENTS, THE TWO AREAS WHERE WE ARE MOST OUT OF LINE WITH THE PRIVATE SECTOR.

ANOTHER ITEM THAT WILL INTEREST THIS SUBCOMMITTEE IS OUR PROPOSAL THAT THE POSTAL SERVICE, AS WELL AS THE DISTRICT OF COLUMBIA GOVERNMENT, BEGIN TO PAY THE FULL COST OF RETIREMENT BENEFITS. WE BELIEVE THAT THESE ENTITIES, WHICH ARE INTENDED TO BE SELF-SUPPORTING, SHOULD PHASE OUT THE HIDDEN SUBSIDY THEY HAVE RECEIVED FROM THE TREASURY IN THE AREA OF EMPLOYEE BENEFITS.

TAKEN TOGETHER, ALL OF THE CHANGES WE ARE PROPOSING IN THE RETIREMENT SYSTEM WILL INCREASE RECEIPTS IN FISCAL YEAR 1987 BY $937 MILLION, AND REDUCE OUTLAYS BY AN ADDITIONAL $667 MILLION.

IN THE AREA OF HEALTH BENEFITS, WE ARE ONCE AGAIN PROPOSING A RESTRUCTURING THAT WOULD INCREASE COMPETITION AMONG HEALTH BENEFITS CARRIERS, AND CONTROL GOVERNMENT COSTS THROUGH A NEW INDEXING FORMULA. THESE CHANGES WOULD REDUCE OUTLAYS BY $1.2 BILLION IN 1987.

IN THE AREA OF EMPLOYEE PAY, THE BUDGET ASSUMES A GENERAL PAY INCREASE OF 3 PERCENT FOR FEDERAL EMPLOYEES, TO BE EFFECTIVE IN JANUARY 1987. THE FINAL DECISION ON THE PAY RAISE WILL BE MADE BY THE PRESIDENT IN AUGUST, AFTER HE REVIEWS THE RECOMMENDATIONS OF HIS PAY ADVISERS.

NOW I WOULD LIKE TO TURN TO THE APPROPRIATIONS REQUEST FOR OPM ITSELF. WE ARE ASKING FOR A SALARIES AND EXPENSES APPROPRIATION OF $99.8 MILLION, THE SAME THAT WAS REQUESTED FOR 1986 BEFORE THE GRAMM-RUDMAN-HOLLINGS CUT, AND ALMOST 25 PERCENT LESS THAN OPM'S BUDGET ONLY 5 YEARS AGO. THIS AMOUNT IS INTENDED TO PROVIDE US WITH A YEAR OF RELATIVE STABILITY WHILE WE LAY THE GROUNDWORK FOR SUBSTANTIAL FUTURE SAVINGS.

WE HAVE BEGUN A CONSOLIDATION OF OUR REGIONAL ACTIVITIES THAT WILL ENABLE US TO REDUCE OUR ADMINISTRATIVE OVERHEAD WHILE MAINTAINING SERVICES. BY THE END OF 1987 WE WILL CONSOLIDATE THE REGIONAL HEADQUARTERS OFFICES OF THE 5 CITIES HAVING THE SMALLEST FEDERAL POPULATIONS WITH THE 5 CITIES HAVING THE LARGEST NUMBER OF FEDERAL EMPLOYEES SERVED. WE WILL MAINTAIN OUR OPERATIONAL PRESENCE IN ALL OF THESE CITIES THROUGH THE RETENTION OF OUR AREA OFFICES. THIS CONSOLIDATION WILL RESULT IN A NET REDUCTION OF ABOUT 135 POSITIONS--OVER 10 PERCENT OF OUR S&E FIELD PERSONNEL--AND, AFTER IMPLEMENTATION, WILL SAVE US MORE THAN $3 MILLION PER YEAR. WE ARE PUTTING A GREAT DEAL OF EFFORT INTO PLANNING THIS RESTRUCTURING, SO THAT THE AFFECTED EMPLOYEES WILL HAVE ENOUGH TIME TO DECIDE WHETHER TO RELOCATE WITH OUR ASSISTANCE OR TO FIND OTHER JOBS, AND SO THAT OUR SERVICES TO AGENCIES AND THE PUBLIC WILL NOT BE DISRUPTED.

WE WILL ALSO BE RESTRUCTURING ASPECTS OF OUR CENTRAL OFFICE OPERATIONS, WITH PARTICULAR EMPHASIS ON REDUCING OVERHEAD AND UNNECESSARY MANAGEMENT LAYERS. FOR INSTANCE, WE ARE GOING TO ELIMINATE ONE ENTIRE ECHELON OF MANAGEMENT, CALLED "DEPUTY ASSISTANT DIRECTORS," FROM OUR S&E ACTIVITIES, AND WE ANTICIPATE MANY MERGERS AND CONSOLIDATIONS OF VARIOUS

ORGANIZATIONAL ELEMENTS AS WE REFOCUS OUR MANAGERIAL RESOURCES ON THE MOST CRITICAL NEEDS. OF COURSE, THERE ARE SOME AREAS WHERE WE ARE GOING TO HAVE EXPENDITURES THAT ARE BEYOND OUR CONTROL, SUCH AS THE REQUIREMENT THAT WE SEND OBSERVERS TO POLLING PLACES UNDER THE VOTING RIGHTS ACT.

FOR OUR ADMINISTRATION OF THE RETIREMENT AND INSURANCE PROGRAMS, WE ARE REQUESTING AN EXPENSE LIMITATION OF $55.4 MILLION, AN INCREASE OF $1.2 MILLION. WE ARE ABSORBING INCREASED WORKLOADS THROUGH HIGHER PRODUCTIVITY AND USE OF ADP, BUT AN INCREASE IS NECESSARY DUE TO INCREASED COSTS FOR SPACE, FOR POSTAGE, AND FOR ADP SERVICES.

THE OPM APPROPRIATIONS ALSO INCLUDE PAYMENTS FOR THE GOVERNMENT-WIDE EMPLOYEE BENEFIT PROGRAMS. WE ARE ASKING FOR $1.5 BILLION TO PAY THE GOVERNMENT SHARE OF THE COST OF HEALTH BENEFITS FOR ANNUITANTS. IN THIS REGARD, I SHOULD MENTION THAT WE ARE ALSO PROPOSING THAT THE POSTAL SERVICE AND THE DISTRICT OF COLUMBIA GOVERNMENT BE REQUIRED TO PAY THIS COST IN THE CASE OF THEIR OWN ANNUITANTS, RATHER THAN CONTINUING TO LEVY THIS CHARGE AGAINST THE GENERAL FUND OF THE TREASURY.

FOR THE CIVIL SERVICE RETIREMENT FUND, WE ARE REQUESTING AN APPROPRIATION OF $4.6 BILLION. THIS PAYMENT, WHICH IS REQUIRED UNDER THE FINANCING SYSTEM ESTABLISHED IN 1969 BY PUBLIC LAW 91-93, REPRESENTS AMORTIZED PAYMENTS OVER A 30-YEAR CYCLE FOR THE RETIREMENT COSTS OF PAY INCREASES AND BENEFIT LIBERALIZATIONS.

IN THE PAST OPM HAS LACKED AUTHORIZING LEGISLATION FOR AN APPROPRIATION FOR RECEPTION AND REPRESENTATION EXPENSES.

TODAY I AM PLEASED TO BE ABLE TO REPORT THAT WE HAVE OBTAINED SUCH AUTHORIZING LEGISLATION, IN PUBLIC LAW 99-251, SIGNED BY THE PRESIDENT ON FEBRUARY 27.

FINALLY, I WOULD LIKE TO MENTION TWO GENERAL PROVISIONS OF PARTICULAR INTEREST TO OPM. ONE IS THE BAR ON PAYMENTS FOR ABORTIONS UNDER THE FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM. THE ADMINISTRATION STRONGLY SUPPORTS THE CONTINUATION OF THIS BAR. THE OTHER GENERAL PROVISION IS THE CAP ON PAY INCREASES FOR FEDERAL WAGE EMPLOYEES. WHILE WHITE COLLAR EMPLOYEES' PAY CAN BE CAPPED ADMINISTRATIVELY UNDER THE PRESIDENT'S ALTERNATIVE PLAN AUTHORITY, WE MUST RELY ON THE GENERAL PROVISION IN THE APPROPRIATIONS BILL TO PROVIDE CONSISTENT TREATMENT FOR FEDERAL BLUE COLLAR WORKERS. WE URGE THAT THIS CAP BE CONTINUED.

THANK YOU. I WOULD BE GLAD TO ANSWER ANY QUESTIONS YOU MAY HAVE.

LEGISLATIVE PROPOSALS

Ms. HORNER. Thank you.

I would like to begin with a brief review of the administration's major budget proposals concerning Federal Personnel Management and then turn briefly to OPM's own budget.

Again this year, we are calling for a major reform in the Civil Service Retirement System. There has been a lot of argument over this system in recent years, but I think it is undeniable that the current system is far more costly than private sector pension plans, and costly in an absolute sense, given the deficit situation. We want to deal with that problem.

We are proposing several changes that will increase revenues to the system and decrease its outlays. Those changes are to increase revenues from employee and agency contributions to the system from 7 to 9 percent, and on the outlays side we are proposing a penalty for those who retire before age 62 and a limit on cost-of-living adjustments. These are the two areas that we believe are most out of line with the private sector.

This committee may especially be interested to know that we are proposing that the Postal Service and the D.C. government begin to pay the full cost of retirement benefits. We think these entities were intended, at least since the Postal Reorganization Act and Home Rule for the D.C. government, to be self-supporting, and their hidden subsidies should be phased out.

All these changes taken together will increase receipts for fiscal year 1987 by $937 million and reduce outlays by an additional $667 million.

In the area of health benefits, we are once again proposing a restructuring to increase competition among health benefits carriers and control the costs through a new indexing formula, thereby reducing outlays by about $1.2 billion in fiscal year 1987.

APPROPRIATION REQUESTS

For OPM's own agency request, we are asking for a salaries and expenses appropriation of $99.8 million, which is the same as we requested for fiscal year 1986 before the Gramm-Rudman-Hollings cut, and almost 25 percent less than OPM's budget only 5 years ago.

We have begun a consolidation of our regional activities to reduce administrative overhead, but we will retain full services in the regions. We are putting a lot of effort into planning this restructuring, doing it over an extended period of time so that we may accommodate the personal needs and concerns of the affected employees through relocation assistance and other kinds of assistance. We will also be restructuring organizations in our central office.

We are asking for $1.5 billion to pay the Government share of the cost of health benefits for annuitants. In this regard, I should mention we are also proposing that the Postal Service and the D.C. government be required to pay this cost for their own annuitants.

For the payment to civil service retirement and disability fund, we are requesting an appropriation of $4.6 billion. This amount represents amortized payments over a 30-year cycle for the retirement costs of pay increases and benefit liberalizations.

PREPARED STATEMENT

I would like to submit for the record a statement regarding a rescission proposal for fiscal year 1986 and another requesting a small change to our appropriation language as a fiscal year 1986 supplemental request, if I may.

Senator ABDNOR. Yes.

[The statement follows:]

STATEMENT OF HON. CONSTANCE HORNER

FISCAL YEAR 1986 RESCISSION PROPOSAL

Mr. Chairman and members of the subcommittee, thank you for inviting me to discuss the President's proposal for a rescission of certain funds that have been appropriated for the Office of Personnel Management for fiscal year 1986.

I am accompanied this afternoon by several members of OPM's staff. They are: Mr. James W. Morrison, Jr., Associate Director for Compensation; Mr. Thomas J. Simon, Associate Director for Administration; Mr. Frank D. Titus, Assistant Director for Financial Control and Management; Mr. John Prebis, Assistant Director for Budget and Management; and Mr. Sidney M. Conley, Chief of the Budget Division.

This rescission proposal relates to the appropriation account that is used to pay the Government share of the cost of health benefits for retired Federal employees. The amount that was appropriated for this account for fiscal year 1986 by Public Law 99-190 is what was originally estimated to be necessary to pay for annuitant health benefits this year. However, under Public Law 99-251, signed by the President on February 27, this account is now going to be supplemented by a new source of cash, namely the Government share of some sizable premium refunds from a number of the insurance carriers participating in our Health Benefits Program.

With this infusion of refund money, we will no longer need $600 million of the amount that was originally requested and appropriated for this account. I want to stress that this rescission is not any sort of benefit reduction, but merely avoiding drawing unneeded money from the Treasury, since the refunds will provide us with enough money.

FISCAL YEAR 1986 SUPPLEMENTAL REQUEST

We are requesting, as a 1986 supplemental request, additional appropriation language to authorize the OPM to use funds already appropriated for offical reception and representation expenses. This authorization is to allow the OPM to carry out responsibilities for programs honoring veterans and handicapped employees and provide information on personnel matters to the public, private industry, State and local officials, and foreign nations.

In the past, this request has been denied due to the lack of authorizing legislation. I am glad to be able to report this year that authorizing legislation has been approved by Congress and is contained in title III, section 301 of Public Law 99-251, the Federal Employees Benefits Improvement Act of 1986.

FLOOR VOTE

Ms. HORNER. Thank you for this opportunity to testify. I would be glad to answer any questions you and the committee have.

Senator ABDNOR. Well, thank you, Ms. Horner.

We may leave you for a few seconds on the second bell. We have to go to vote.

Mr. Mattingly, do you want to lead off with any questions?

Senator MATTINGLY. Mr. Chairman, I have some questions for the record and that will be all.

Senator ABDNOR. We will submit Senator Mattingly's questions for the record and you can answer them at a later time.

Senator ABDNOR. Senator DeConcini.

Senator DECONCINI. Mr. Chairman, thank you.

COMBINED FEDERAL CAMPAIGN REGULATIONS

Director Horner, you know what one of my favorite subjects is—we have discussed at some length—and I would like to go over it a little bit. I am concerned about the Combined Federal Campaign Regulations that were issued by your office on April 4.

First, let me say that I was disappointed that the changes I had requested regarding the certification process were not taken very seriously. I believe that the genesis of the problem facing OPM every time they try to write CFC regulations is that they have not been sensitive to the concerns raised by Congress, not just this Member.

Two meetings were held between representatives of OPM and international service agencies in January and February, but ISA was unable to get an appointment with you until April 3. Frankly, it seemed to me that it is a fait accompli at that point since the regulations have been at OMB since early March and were sent to the Federal Register the morning of April 3.

So that being the case, at this point I guess it is water under the dam and we can revisit that at other times and in other ways. And I wanted to proceed to try to get an understanding of why the certification changes that were urged were not accepted, and to look at ways that might make some changes.

Under the regulations issued April 4, all federated groups are allowed certification authority for member organizations except international service agencies. In meetings between ISA, my staff and OPM, no reason was given for that exclusion, and subsequently, we offered three alternatives that would solve these problems. One alternative we provided OPM could determine for overseas service organizations the international presence requirement, while allowing ISA to certify the other requirements in the same manner allowed, say the United Way, National Health Agencies, and other federated groups.

In the final rule, you state:

> Given the nature of overseas service organizations and the significant impact of their policies and practices on U.S. foreign policy, it is especially important that their applications be closely scrutinized by OPM.

The regulation also specifically states that the agencies participating shall provide:

Direct and substantial health and welfare services, all of which shall be consistent with the laws and policies of the U.S. Government.

Clearly, should a participating agency act in opposition to laws and policies of the U.S. Government, including foreign policy, OPM could step in and remove them from the campaign.

Additionally, I have to wonder who at OPM will make judgments on American foreign policy. In past campaigns, this issue was never raised, and I do not know of any instance where an overseas service organization impinged on American foreign policy.

Perhaps you could address these concerns and give this committee a clear understanding of why you have treated international service agencies so different from other federated groups.

Ms. HORNER. Yes, Senator.

To address first your earlier comments, I deferred publication of these rules last summer, shortly after my confirmation because of conversations I had with you, with Senator Mathias, Senator Durenberger and other Members of Congress.

Senator ABDNOR. Is it all right with you if we go to vote and come back?

Ms. HORNER. Certainly.

[A brief recess was taken.]

Senator DECONCINI. In the absence of the chairman, who is on his way back, and seeing that I am in the midst of questions here, please proceed, Ms. Horner. I am sorry to do that to you. I interrupted your thoughts.

Ms. HORNER. It was for a very good cause, I am sure.

I was just about to say that last summer, immediately after I was confirmed, I faced the prospect of deciding whether to publish and implement these regulations and have them applicable last summer, as under the Supreme Court ruling and the Presidential Executive order it was permissible to do. It was, in fact, advisable to do that. But because of strong suggestions from a few organizations, transmitted largely through Members of the Congress, I concluded that there would be some jeopardy to the smooth execution of the campaign. And, therefore, I decided, considering those congressional comments, it would be wise for me to defer publication of the rules in final. I published them on August 22 and deferred final publication.

CONSIDERATION OF INTERNATIONAL SERVICE AGENCIES

Now, you have expressed some concerns about the degree of consideration ISA's concerns have received from us. In fact, they have been given more attention than virtually any other issue in the CFC during the comment period. Our General Counsel's Office met several times with ISA representatives. Our policy advisor met at least one time. There were several phone conversations between our Office of General Counsel and ISA.

And in January of 1986 our Congressional Relations Office began an extensive survey of congressional offices to ensure that no one's concerns were overlooked in the comment period. We did not have to embark upon that broad consultation, but because I want to work well with the Congress and closely, we did.

In fact, we held up final publication for some period of time in order to give lengthy consideration to ISA concerns. And, in fact, in one case we did reverse our position with respect to the 25-percent limit on administrative expenses. So, I feel very strongly that we have consulted broadly, taken sufficient time for broad consideration.

Nonetheless, we are going to have to disagree with someone any time we make a decision where there are differing opinions, opinions on both sides.

Now to respond to your specific question relating to our rationale for declining to accept ISA's proposal that it be a certifying agency, there must be a strong nexus between the organizations associated with and the processes involved in executing the Combined Federal Campaign. We expend somewhere between 20 and 30 million dollars' worth of Federal employee time on this campaign. And, in fact, representatives of the Federal Government, Federal employees, are involved in it. So there is necessarily a governmental connection.

Therefore, we need this kind of connection in both the domestic and the international spheres to begin with.

In the domestic sphere, we have it through the requirement for establishing local presence.

Now, in the international sphere I believe that this nexus between the Government and the campaign must be much stronger. And that is why I declined to accept ISA's recommendation.

The Government, the President in the exercise of his foreign policy powers and decisionmaking requirements, must have a great deal of opportunity for information and influence. And I feel that it would not be appropriate to put the Federal Government in the position of simply accepting or rejecting a private agency's recommendation for the simple reason that such a rejection in itself can become a diplomatic event. It is not a simple matter of giving OPM ultimate oversight because a reversal of a recommendation becomes, in the public realm, a foreign policy decision potentially. That is why I felt that I had to make the decision I did.

Senator DECONCINI. I do not quite understand you. Is that your own personal decision?

Ms. HORNER. Yes, it is.

Senator DECONCINI. It is. My information is not nearly as extensive as, perhaps, your information is with respect to how many meetings you had with ISA. My information is that there were two meetings held between representatives of OPM and international service agencies in January and February, but that ISA was unable to get an appointment with you until April 3. So, there is some misunderstanding here as to consultation. You may have called every congressional office, but, you know, if they cannot meet with you and hear back about their suggestions that they gave you in January and February, it does not leave them in a very good state of mind, nor does it leave this Senator in a very good state of mind.

Now you give me a little different reason than what you state. In your rule you state that:

> Given the nature of overseas service organizations and the significant impact of their policies and practices on U.S. foreign policy, it is especially important that their applications be closely scrutinized.

Now is that the reason, the foreign policy reason, that you made reference to here?

Ms. HORNER. Yes, Senator, it is.

Senator DECONCINI. Now you feel that the ISA, if they are representing these agencies, is a foreign policy matter.

Ms. HORNER. No, Senator. It is not a foreign policy matter in itself. The process recommended by ISA has potential foreign policy impact.

Senator DECONCINI. For instance? Can you give me a for instance?

Ms. HORNER. It is important to preserve general authorities and opportunities in this area without having to project a specific adverse outcome.

Senator DECONCINI. What does that mean? Give me an example please.

Ms. HORNER. An example, you want me to make up an example of how there might be——

Senator DECONCINI. Yes; give me a hypothetical example. I do not know what you are talking about.

Ms. HORNER. Well, for instance, AID is a contributor to many of these agencies, which then distribute AID money. Therefore, there already is a State Department foreign policy connected with AID recipients.

Senator DECONCINI. Yes.

Ms. HORNER. Now if there is a decision made vis-a-vis AID disbursements of funds, that necessarily impacts some of these agencies. In the course of OPM review of applications, we, being members of the Government, would be simply aware of foreign policy considerations in a way that a private organization would not necessarily be aware.

Senator DECONCINI. And yet if you had under the rule that you could stop it at any time if they are not in compliance with laws and policies of the U.S. Government, is that not a very wide discretion? How would that affect foreign policy?

Let me give you a hypothetical example. Let us say if you did recognize ISA here and you decided that CARE had some problem and you did not want CARE in there or Meals for Millions or Catholic Relief Service, the biggest operator in Ethiopia, for instance—you thought there was something wrong there, if they were in opposition to laws and policies, not just statutory laws of the U.S. Government—then OPM could step in and remove them from the campaign. Now what is the matter with that, Ms. Horner?

Ms. HORNER. The problem is that policymaking occurs sometimes on an hour-to-hour basis in the U.S. Government. For instance, in terms of our relationships with Libya, there are hour-to-hour decisions being made. And it seems likely to me that if we were to receive a recommendation and then, as the U.S. Government, reject it, that would limit the President's freedom of movement because there would be public discussion of a particular act of rejection on his administration's part. Given the hour-to-hour requirements in some cases, such a process would be ill advised.

Now, I will say, Senator, that I believe we are speculating about possibilities here. I would not anticipate probabilities. I am only trying to retain Presidential opportunities for the possibilities. I would not want to say that I would consider these events to be likely.

Senator DeConcini. Will you not still have that Presidential authority to do it? If CARE has to come in by itself or Catholic Relief Services, and an hour-to-hour decision is—if your job is so sensitive in foreign policy that it has to be hour to hour with what is going on in foreign policy, and you determine it is OK for CARE, it is OK for Catholic Relief Services or Save the Children and then something goes wrong, you are faced with that same problem. You are faced with the same political; international problem and you would have to say "I am sorry, CARE; whatever the heck you are doing, it is against our policy and we are not going to certify you".

What bothers me, Ms. Horner, is there seems to me to be some underlying reason here that is not up on the table, and I would much rather disagree with you on something that is totally up on the table.

My interest in this is I got into it because of Meals for Millions. And after I went to Ethiopia and I saw Catholic Relief Services operating, I said, "My gosh sakes, there is no reason why these organizations should have to apply individually to get this certification." And my interest is trying to find some accommodations so these good organizations can be part of the voluntary giving.

And it seems to me like your answer that it is a foreign policy hour-to-hour decision, when, in fact, that is what you would have if Save the Children had applied separately and been certified, and the hour-to-hour policy decision on foreign policy made it that you did not want them, you would be confronted with the same thing.

Ms. Horner. Except there is a period of precertification when no event has yet occurred. But I understand we are getting to fine points here. And I would like to assure you that we hope to work very closely with ISA, that we think it is a very fine organization. And we feel that there is broad opportunity for its members to use its assistance in preparing applications. And, therefore, we believe that organization can be of great help to its member agencies. We would hope to support it in any way that we can other than this particular rule, which, frankly, I think overburdens the requirements for support and there are other ways that this can be done.

Senator DeConcini. I just have to disagree with you. It seems to me that you are saying you want to work and cooperate with them and then you cut them off at the knees, where they most need the cooperation, just so all these agencies do not have to hire people and come in and go through this process. And they have an organization that is legitimate and you say they are OK, no problem with them.

Ms. HORNER. Well, we trust that they will still get assistance from ISA in this regard.

Senator DECONCINI. And what are you going to do? Catholic Relief Services, instead of taking that money and giving it to people in Ethiopia, are going to have to go through the administrative costs now, in addition to whatever they already pay or contribute to ISA. They are going to have to go spend that themselves now instead of giving it to the people in Ethiopia. Boy, that does not make sense.

Let me ask one more question, Mr. Chairman, then I will relinquish the floor if that is fine.

Senator ABDNOR. Fine.

INCREASES IN STAFFING SERVICES

Senator DECONCINI. You are requesting an increase of 20 full-time equivalent slots and $510,000 to fund them. These would be used to handle increases in the nationwide automated recruitment and exam system resulting from the full implication of the new PACE exam. What would be the effects of your operation if we were to deny these requests for your staff and money?

Ms. HORNER. We would have to delay the implementation of this examination process.

Senator DECONCINI. How long would that delay be?

Ms. HORNER. I would like to supply that for the record, if I may.

Senator DECONCINI. Do you have an alternative in mind if it is delayed or it is not funded in full?

Ms. HORNER. I do not know whether my staff has planned for that alternative. I would like to supply it for the record.

Senator DECONCINI. Would you let us know?

Ms. HORNER. Yes.

Senator DECONCINI. OK.

And the other one I will submit for the record.

Thank you, Mr. Chairman.

[The information follows:]

Plans to expand the time period during which OPM accepts applications for those PACE alternative tests for Internal Revenue officer, Customs inspector and contract and procurement specialist positions, which were partially implemented in 1986, would be dropped and announcing competitive testing for Social Security claims examiner would be delayed under fiscal year 1988 in the hope that additional funding would then be made available.

If funding is delayed or not granted at all, we would continue to rely on agency hiring noncompetitively through schedule B authority, which critics say is inadequate to assure quality entry-level candidates. Partial funding would enable us to implement competitive examinations for some but not all of the job categories. The number and fequency of testing would depend on the amount of funds made available.

However, deferring the full implementation of these newly developed competitive exams would limit our efforts to supply quality candidates for agency consideration and prevent us from being in full accordance with merit system principles prescribed by law.

FISCAL YEAR 1986 GRAMM-RUDMAN-HOLLINGS REDUCTIONS

Senator Abdnor. For the record I would like to ask you how you applied the Gramm-Rudman-Holiings' reductions.

Ms. Horner. We would be happy to do that.

Senator Abdnor. We have been asking that as a standard question because, you know, people are on pretty tight budgets. So are my agencies, I can tell you.

[The information follows:]

To absorb the Gramm-Rudman-Hollings reductions of nearly $4.3 million in our salaries and expenses appropriation and over $2.3 million in transfer authority for administration of the retirement, health benefits, and life insurance programs, we have taken direct action to reduce spending by instituting budget restrictions for all organizations throughout the agency. These restrictions apply to travel and other objects expenditures, as well as personnel costs. In the area of personnel, we have imposed a hiring freeze and are limiting the replacement of employee losses to only the most critical positions. Also, there are restrictions on employee overtime. In regard to other objects, spending for paper, supplies, printing, and the like is limited to only those items essential to mission accomplishment.

In order to accommodate the reduction in authority for trust fund administrative expenses, we made changes in operating practices. To reduce postage expenses, we did not mail a customary notice (changes in health benefits premiums) to approximately 1.3 million annuitants. In the printing area, we have requested our health benefits carriers to print and distribute their own brochures to employees, annuitants, and Federal agencies. Despite these and other actions which reduced our administrative costs by well over $1 million—saving 10 furlough days for employees paid from trust funds—it has been also necessary to cancel the recruitment of 25 retirement claims examiners. These actions have reduced our customary service levels and, thus far, have caused an increase in our pending retirement claims balance.

At this time we are hopeful that these measures will allow us to meet our reduced levels without having to implement an employee furlough.

Also, in our entitlement budget, the appropriation for the account which funds the Government contribution for annuitants' health benefits was reduced $69 million. Fortunately, this account had accumulated an unobligated balance, really a reserve, which was more than sufficient to absorb the first year 1986 reduction without any adverse impact on the Government's ability to meet its obligations. Future year reductions will, of course, be problematical.

RETIREMENT AND HEALTH BENEFITS PROPOSALS

Senator Abdnor. The administration is seeking changes in both the Retirement Program and the Health Benefits Program. Could you give us an idea of how Federal expenditures would be impacted if these changes are enacted? And how about if they are not? Let us talk about it both ways.

Ms. Horner. Well, Mr. Chairman, if they are enacted, Federal outlays will be reduced over a 5-year period by almost $20 billion, including both of those programs; $15.6 billion for the retirement program itself. If they are not enacted, there will be some adverse policy consequences and also the loss of that outlay reduction.

RETIREMENT SAVINGS ATTRIBUTABLE TO THE POSTAL SERVICE

Senator ABDNOR. Could you tell us what part of that $15 billion comes from the Postal Service and will it be broken out?

Ms. HORNER. May I supply that for the record please?

Senator ABDNOR. OK.

[The information follows:]

The savings identified in the President's budget are limited to the increased contributions that will be received from employees, the D.C. government and reductions in retirement outlays. The $15 billion estimate does not include any savings associated with the Postal Service as an employer because it is an on-budget agency and any additional contributions it will make are treated as intragovernmental transfers that will not affect the deficit. However, we estimate that the Postal Service would contribute an additional $435 million in 1987 if our proposals are enacted.

PROPOSALS ON RETIREMENT AGE AND CONTRIBUTIONS

Senator ABDNOR. Let me ask you one other thing while we are on this retirement. I guess we have a better retirement program, no question then out in industry. But I have seen people leave here who have gone out and made two and three times the salary they made here. And sometimes that becomes a part of the decision to stay with a career; you need those kind of people. Do you think this might have some adverse effects?

Ms. HORNER. The retirement proposals?

Senator ABDNOR. Yes.

Ms. HORNER. I think the appropriate way for the U.S. Government to address a problem of not enough pay, which may lead some of these higher-level executives to leave, is to tailor their pay more to what the market demands. I think that our high-level executive pay is not sufficient in some cases, and that it is more likely pay than retirement.

Additionally, some people stay on beyond the time they want to stay on in the Federal Government in order to collect retirement because of its generosity.

Senator ABDNOR. When did this start, I mean, under the plans as you see it? All employees in the Federal Government start immediately on this 2-percent increase?

Ms. HORNER. The increase in contributions would begin in January 1987.

Senator ABDNOR. How about this age thing? When does that start applying?

Ms. HORNER. I am sorry. Would you——

Senator ABDNOR. Well, you said they cannot retire as early as they used to. I think 62 it is.

Ms. HORNER. Yes; employees who retire before age 62 would lose 2 percent for each year they are under age 62.

Senator ABDNOR. Now they do not.

Ms. HORNER. That is correct.

Senator ABDNOR. If they have enough years combined with——

Ms. HORNER. Now they retire on full benefits at age 62.

Senator ABDNOR. That goes in immediately?

Ms. HORNER. At age 55, excuse me. Now they retire on full benefits at age 55.

Senator ABDNOR. And this would be 65 now?

Ms. HORNER. Sixty-two.

Senator ABDNOR. Sixty-two.

Ms. HORNER. We would begin reducing according to age at retirement up to age 62.

Senator ABDNOR. How about if the person is 61½, does he have any breaks in this?

Ms. HORNER. May I ask Mr. Morrison to respond? He knows the details of this.

Senator ABDNOR. Sure, go right ahead.

Mr. MORRISON. Yes, sir, Mr. Chairman. The proposal is to reduce the earned annuity by 2 percent per year for every year between age 55 and 62. But, a person who is 61½ on the date of enactment would not lose anything because of grandfathering. We would grandfather-in people who are 55 years old and older on the date of enactment while a 54-year-old person would lose one-half of 1 percent, a 53-year-old, 1 percent and so on.

But at some point, if you are under 51 on enactment, for example, and retire any time between ages 55 and 62, then you would have the full 2-percent reduction applied to your annuity for each year under age 62.

So there is both a grandfathering and a phasing in.

VOTING RIGHTS OBSERVATIONS

Senator ABDNOR. Finally, you are seeking an increase in positions to enforce the Voting Rights Act. And do you anticipate that more elections will need to be monitored? Is that——

Ms. HORNER. Because of the elections, yes. I think we received estimates from the Justice Department as to what to expect.

Senator ABDNOR. How do you determine which elections are qoing to be monitored?

Ms. HORNER. Requests from the Justice Department make that determination.

Senator ABDNOR. You do work with the Justice Department on that?

Ms. HORNER. Yes.

RETIRED EMPLOYEES HEALTH BENEFITS

Senator ABDNOR. A drop is being projected in the number of participants in the Retired Employees Health Benefit Program. And to what will this be attributed?

Go ahead, Mr. Morrison. Do you want to answer?

Mr. MORRISON. Yes, sir. That program, sir, is for people who retired prior to 1960. That is a very small population—very elderly people who are a declining population. There is a very high mortality rate now for this group.

SEQUESTRATION OF GOVERNMENT PAYMENTS FOR HEALTH BENEFITS

Senator ABDNOR. Gramm-Rudman-Hollings requires a reduction of $69 million in the "Health benefits" account. Will this reduction cause problems and will coverage be reduced?

Ms. HORNER. It will not cause problems nor will coverage be reduced in fiscal year 1986. We have projected an unobligated balance of $285 million at the end of fiscal year 1986, which allows us to absorb the Gramm-Rudman-Hollings reduction with little difficulty.

However, if Gramm-Rudman-Hollings automatic cuts were to go into effect in fiscal year 1987, then there might be a problem.

Senator ABDNOR. Well, we needed that for the record because we feel that is one of the accounts that should have been exempted from Gramm-Rudman and was not.

In recent years OPM has reduced its manpower significantly. Has this impacted your ability to process your work?

Ms. HORNER. Mr. Chairman, I think our processing of our work is very much improved and has improved over the course of these reductions because of ADP improvements, some contracting out and general management improvements.

Senator ABDNOR. Well, good. Productivity has gone up and manpower down.

How long does it take to process on the average a retirement plan?

Mr. MORRISON. On the average, sir, about 35 days to process a claim, if all the documentation is with the package at the time we receive it. That is 35 days within the Office of Personnel Management.

Senator ABDNOR. How long would it have taken you 5 years ago on the same——

Mr. MORRISON. Five years ago we were up as high as—do you recall, Frank—80 days.

Mr. TITUS. At least double.

Mr MORRISON. At 75 to 80 days 5 years ago.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Well, Ms. Horner, I have some other questions but we will just submit them in writing.

And thank you very much, you and your group, for your appearance here today.

Ms. HORNER. Thank you very much, Mr. Chairman.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

OPM PERSONNEL STRENGTH

Senator Abdnor: You are seeking an increase in staff of 17 positions. What will these positions be used for?

Ms. Horner: The FY 1987 request for an increase of 17 full-time equivalents (FTE's) in Staffing Services is necessary to process expected increases nationwide in examination and recruitment requests resulting from the implementation of alternative tests to replace the Professional and Administrative Career Examination (PACE) for various entry level positions. This change in employment testing was directed by a consent decree approved by the U.S. District Court.

Senator Abdnor: Will they be offset by reductions elsewhere?

Ms. Horner: Yes. Decreases of 24 FTE's in ADP Services, 25 FTE's in Compensation, 42 FTE's in Workforce Effectiveness and Development, and 18 FTE's in Compliance and Investigations are planned. These reductions result in a net decrease of 91 FTE's in OPM's total personnel strength for FY 1987.

REDUCTION IN ADP SERVICES

Senator Abdnor: You have reduced your ADP Services. How has this been done?

Ms. Horner: The reduction in ADP Services is based primarily on savings achieved by contracting out work in conjunction with A-76 initiatives; identifying efforts that can be produced more efficiently using private sector sources.

Senator Abdnor: How will your day-to-day operations be impacted?

Ms. Horner: Daily operations should not be affected since many private sector firms can perform these ADP services and agency employees will carefully monitor the contracts.

HEALTH BENEFITS REBATES

Senator Abdnor: The health benefit carriers have begun to rebate funds to employees. Is OPM monitoring this rebate? How long will it take? Has the Federal government received its rebate yet?

Ms. Horner: Yes, OPM is monitoring the rebate of funds by health benefit carriers to employees. When carriers begin the refund process, they have been instructed to submit a monthly "Status Report of Special Reserve Refunds." Three of the 12 carriers have actually issued rebate checks to eligible FEHB enrollees; another three carriers anticipate having checks issued to enrollees by the end of April. These six carriers account for approximately 99% of the enrollees scheduled to receive rebates. The remaining six carriers are at an earlier stage of the rebate process. It is not known how long it will take before all eligible enrollees have received their rebates. The Federal government has received its share of rebates from five of the 12 carriers, amounting to over $500 million of the $670 million that the government is slated to receive.

WORKFORCE EFFECTIVENESS AND DEVELOPMENT TRAINING

Senator Abdnor: The number of positions is being reduced in the Workforce Effectiveness and Development Activity of the Revolving Fund, yet the funding level is going to increase. To what can this be attributed?

Ms. Horner: The decrease of 42 FTE's in the Workforce Effectiveness and Development Revolving Fund program will be accomplished by using more contract instructors, in place of OPM personnel, to provide training courses. The increase of over $3 million in obligations is based on anticipated growth in the training program.

SPACE MANAGEMENT EFFORTS

Senator Abdnor: Have you reached the 135 square foot goal? If not, why and what is your target date?

Ms. Horner: The Office of Personnel Management has made a determined effort to achieve the 135 square foot goal in accordance with Federal Property Management Regulation D-71 issued in June 1985. All data regarding office space and supplemental office space were submitted to the General Services Administration (GSA) for approval in January 1986. When supplemental space for job information, testing, training, conference rooms, ADP, records and files, tape libraries, reception areas, etc., is excluded, OPM has met the 135 square foot per person goal. Further, with GSA's help in reconfiguring our central office building, and acquisition of modular furniture systems, we can improve markedly our present use of space.

FY 1987 IMPACT OF GRAMM-RUDMAN-HOLLINGS SEQUESTRATION

Senator Abdnor: Your request for FY 1987 does not include adjustment for the Gramm-Rudman-Hollings sequestration. If that total was applied to your 1987 request, what would happen? Would it be too much to assume that if you lived with the reduction in FY 1986, you could certainly utilize that level as a base in 1987?

Ms. Horner: OPM's FY 1987 Budget Request is based on guidance from the President and OMB that the "maximum deficit amount" set for FY 1987 in Public Law 99-177 is not exceeded by the President's Budget, therefore making further sequestration of funds unnecessary. However, if OPM's Salaries and Expenses appropriation is reduced by $4.3 million in FY 1987, equivalent to the FY 1986 sequestration, planned agency operations will have to be revised. OPM faces a number of increases in FY 1987 that are not present during FY 1986. More Voting Rights observations, directly related to an increase in elections during FY 1987, will be required. Additional alternative testing, to replace the Professional Administrative and Career Examination (PACE), must be implemented for various entry level occupations to comply with a court approved consent decree. Further, agencywide costs are expected to be higher for rental of space controlled by the General Services Administration, telephone equipment, lines and service, mail services, rental of data processing equipment, and contracts and purchases from private sector sources.

While OPM has taken decisive fiscal management action in FY 1986 to limit and reduce spending on replacement of personnel losses, overtime, awards, travel/per diem, and various categories of other objects (e.g., printing, supplies, material, equipment, etc.), it is likely the extent of this year's savings could not be realized in FY 1987.

In short, if the same FY 1986 sequestration amounts are applied to FY 1987, the current level of operations in specific program areas would necessarily be reduced to accommodate required increases for other programs and absorb the higher costs expected for general goods and services applicable to the entire agency.

Questions Submitted by Senator Mack Mattingly

LEGISLATION ON EARLY RETIREMENT

Senator Mattingly: As you are aware, many Federal workers could become eligible for early retirement this year under a bill introduced by Senator Roth, S. 2197. Could you please give us your thoughts and views on this legislation, and what effect you foresee it having on the Federal work force?

Ms. Horner: Senator Roth's bill is certainly an interesting concept as a way of helping everyone deal with the budget cuts we're facing. We are studying this idea very carefully. Obviously, we have to be concerned about such aspects of the bill as its costs to the Civil Service Retirement System, the workability of the proposed hiring freeze, and the bill's impact on the agencies' productivity and ability to carry out their missions. We haven't reached any final conclusions yet.

NORMAL COST CONTRIBUTIONS

Senator Mattingly: You mentioned in your testimony that one change OPM is interested in is having the Postal Service and the District of Columbia Government begin to pay the full cost of retirement benefits. Could you tell the Subcommittee how much in savings this would amount to?

Ms. Horner: The savings identified in the President's Budget are limited to the increased contributions that will be received from the D.C. Government and will amount to $13 million in FY 1987 and total $214 million from FY 1987 through FY 1991. No savings were displayed in the President's Budget associated with the Postal Service because it is an "on-budget" agency and any additional contributions it makes to the Civil Service Retirement and Disability Fund are treated as intragovernmental transfers of funds which do not affect the government deficit.

FEDERAL ELECTION COMMISSION

STATEMENT OF JOAN D. AIKENS, COMMISSIONER AND CHAIRMAN

ACCOMPANIED BY:

JOHN WARREN McGARRY, COMMISSIONER AND VICE CHAIRMAN, CHAIRMAN OF THE FINANCE COMMITTEE

THOMAS JOSEFIAK, COMMISSIONER AND VICE CHAIRMAN OF THE FINANCE COMMITTEE

JOHN C. SURINA, STAFF DIRECTOR

CHARLES N. STEELE, GENERAL COUNSEL

INTRODUCTION OF ASSOCIATES

Senator ABDNOR. Our next witness will be Joan Aikens, the Chairman of the Federal Election Commission, who will make a brief opening statement and then Mr. John McGarry, the Vice Chairman, who will give more comprehensive remarks.

Joan, we welcome you back to the committee. You are an old pro at this, and feel right at home.

Ms. AIKENS. Thank you. We are delighted to appear before you today.

Senator ABDNOR. Thank you. You can introduce your panel.

Ms. AIKENS. With me is John McGarry, our Vice Chairman and Chairman of the Finance Committee, who will give the testimony; Commissioner Thomas Josefiak, who is Vice Chairman of the Finance Committee; Charles Steele, our general counsel; and John Surina, our staff director.

Senator ABDNOR. Welcome, gentlemen.

Ms. AIKENS. Before I turn the microphone over to Vice Chairman McGarry, I just want to say a few words.

RESPONSE TO FISCAL CRISIS

I want you to know and the committee, Mr. Chairman, that the Commission has tried to respond promptly to the fiscal crisis imposed by the Balanced Budget and Deficit Reduction Act. The Finance Committee spent many, many hours reviewing our options. The recommendations of that committee were approved unanimously by the Commission.

The decisions we reached were not reached lightly or without a great deal of thought, discussion, and research. And we are continuing to look for ways in which we can better administer the law and still provide the additional services of which we have been so proud in the past.

In requesting a supplemental appropriation for 1986, we are asking for less than the amount of the 5-percent pay cut, but enough to permit us to reactivate computerization of campaign finance data.

I am further pleased to report that the Commission has relocated at our new facilities at 999 E Street, and we invite the members and staff to come down and inspect those facilities.

And now the Vice Chairman of the Commission and Chairman of the Finance Committee, John McGarry.

STATEMENT OF JOHN WARREN McGARRY

PREPARED STATEMENT

Mr. McGARRY. Thank you, Chairman Aikens, and good afternoon, Mr. Chairman.

Mr. Chairman, I also will summarize and offer for the record the prepared statement of the Federal Election Commission, containing our fiscal year 1987 budget request.

Senator ABDNOR. Without objection, the entire statement will be made a part of the record.

[The statement follows:]

STATEMENT OF JOHN WARREN MCGARRY

Mr. Chairman, I am happy to be back before you to testify in support of the Federal Election Commission's Fiscal Year 1987 appropriation request. We seek your support for funding of no less than $12.8 million.

Introduction and Summary

This is a watershed period for the Federal Election Commission. Depending on Congressional action taken over the next few months, we will either be able to continue our unequaled record of public service, or we will see much of the progress made over the past decade reversed.

Last September, the Commission proposed a $13,338,500 base level budget to Congress and the Office of Management and Budget. That represented the resources which we believed would be adequate to maintain program activities in Fiscal 1987 consistent with 1985 and 1986. Circumstances have changed significantly since that time, particularly with enactment of the Balanced Budget and Deficit Reduction Act.

Faced with the reality of Government-wide cut backs, the effects of which we are already experiencing, the Commission has agreed to the Administration's proposal of $12.8 million for 1987. Our agreement is predicated on a promise from OMB to decrease our rent and their understanding that $12.8 million is the minimum "Gramm-Rudman-Hollings" level at which we can efficiently provide basic services in the face of increased workload.

Dramatic Campaign Growth Confirmed

When Commissioner Aikens and I appeared before you last year, I reflected on the dramatic growth in campaign finance activity and its impact on our operations. I can now report that my expectations were surpassed in all respects.

You may recall that I projected that total spending for the 1984 elections would go over the one billion dollar mark. In fact, disbursements in connection with the 1984 elections exceeded $1.265 billion dollars, including $218.8 million spent by presidential candidates. That, Mr. Chairman, is an incredible one-third increase from both the 1980 and 1982 elections. I also said that our staff would meet the resulting increased demands despite limited resources, and we did!

In past election cycles, the Congressional elections following a Presidential year have cost as much as the prior Congressional and Presidential contests combined. If that pattern holds true, 1986 campaign finance activity will approximate that of 1984. In 1988, when the presidential nominations in both major parties will be hotly contested, there could be 20 or more publicly-funded candidates. If that proves true, campaign spending will be astronomical.

Workload and Productivity

This projected increase in financial activity, of course, has implications for the Commission. There will be more informational calls and press inquiries; more pages of reports; more presidential certifications -- possibly requiring processing as early as January 1987; more audits under Title 26; more work for every division.

Comparing Fiscal 1985 with the last comparable period --1981 -- we also see drastic growth, far beyond our projections. For example:

-- There were 108,000 informational requests, calls and visitors, up from 80,000;

-- 64,000 documents were coded and entered into our data base, compared to 50,000 in the eariler period;

-- The number of reports reviewed increased 74 percent;

-- Enforcement matters increased from 130 to 360;

Beyond sheer quantity of information provided to the Commission, many of the issues presented through advisory opinion requests, enforcement matters and audits have grown more complex in nature, requiring greater expenditure of time and effort by staff, the Commissioners, and the concerned political committees.

Despite this burden of a vastly expanded workload, we have been able to meet our obligations in a timely and efficient manner. The review of all reports and statements from the 1984 election cycle was completed five months earlier than in the 1980 cycle. The number of days to code and enter detailed transactions into the computer was cut in half, to 30 work days. The final 1984 Reports of Financial Activity, providing detailed, verified data on the elections, were released two months earlier than those for 1980.

While improving our timeliness in the face of a growing workload, we have also been able to enhance both our disclosure and outreach programs -- up to this point, that is.

Cutbacks in 1986

The President's steady-state budget for the Commission for Fiscal Year 1986 -- a figure to which, you may recall, we acceded -- was $12,756,000. We have, however, endured two separate budget reductions. A $323,000 cut was incurred when the President recommended a five percent reduction in federal salaries. The salary cut proposal was later withdrawn, but the funds were not restored to our appropriation. Another $535,000 flowed from the automatic operation of the Balanced Budget and Deficit Reduction Act. Our budget this year has been decreased to $11,898,000, a reduction which has had a negative impact on the entire agency.

We fully appreciate that all agencies must meet the deficit reduction mandated by Gramm-Rudman. However, neither the President, the Congress, nor the Commission expected that the 4.3 percent across-the-board cut for 1986 would be applied against a base reduced by $323,000 on the assumption of a pay cut which never materialized. While the combined dollar amount is not significant by overall

Government standards, this reduction proved to be extremely disruptive to a small, personnel-intensive agency such as ours.

Mr. Chairman, we looked at a number of ways to meet our mandated 4.3 percent cut. For example, if we were to execute a reduction-in-force (an approach discouraged by OMB), additional funds would have to be expended to cover the costs of involuntary separation. Based on our prior experience, a separation at mid-year, for example, costs about 30 cents for every dollar in salary saved. In addition, RIFs displace a greater number of lower level staff than intended, as higher level staff whose jobs have been eliminated exercise bump and retreat rights. As a result, high paid professional staff end up performing lower level and clerical jobs, while still receiving their original salaries. As, you can see, savings from reductions-in-force (RIFs) are somewhat illusory.

By a unanimous Commission vote taken on January 30, we reluctantly adopted a number of austerity measures. While many cuts -- such as training, travel and incentive awards -- were imposed agency wide, our disclosure program was, unfortunately, hit the hardest. The decision to curtail some of our computerized disclosure program was reached only after weeks of agonized deliberations by our Finance Committee. We are cutting personnel costs, but are doing so in the most efficient and least disruptive manner -- by freezing our staff level at the current 234 FTE, even though the figure agreed upon by OMB and Congress is 245 FTE. As a result, we are not hiring the 15 additional people we had planned on as the election approached, and we are not filling 7 existing vacancies.

Disclosure is the essence of the FEC program. The Commission takes great pride in our efforts, which we think enrich what is mandated by law. Detailed computer summaries, special data analyses, and free link-ups with state disclosure offices are FEC initiatives to improve our public disclosure. Yet, this performance has obviously led to expectations by some that such service must continue -- even at the cost of mandated activities, including enforcement and our small Clearinghouse program, which has already been cut more than 90 percent from previous levels.

Enforcement of the Federal Election Campaign Act by the Commission is mandated by law. Complaints must be addressed, advisory opinions issued, regulations drafted, the Commission represented in court, and audits conducted to assure accountability for public funds. Without enforcement, the light of disclosure would be rapidly darkened to the shadows of prior years. I well recall my experience as Chief Counsel of the Special House Committee to Investigate Campaign Expenditures before establishment of the Federal Election Commission. From this experience, Mr. Chairman, I am convinced -- and so are the Commissioners -- that FEC enforcement is essential to disclosure. As a result, the Commission has not tampered with its mandated enforcement responsibilities in making the tough budget choices required this year by Gramm-Rudman-Hollings.

The Commission hires personnel according to need, especially in the data and entry areas. The Gramm-Rudman-Hollings cut occurred at the point before we had hired staff for the election year surge of information. The money to hire additional coding and entry staff was pulled before it was committed. While this enabled the Commission to follow OMB guidance by reducing its personnel costs without firing people, it struck directly at our automated disclosure program. Absent the temporary staff to code and enter the data, additional savings could be realized by rolling back some of the computer service contracts.

The combined impact of the cuts, including a 20 percent reduction in computer storage and 25 percent drop in computer memory, is resulting in the following:

- -- All information from election cycles prior to 1984 is being taken off-line;
- -- Contributions from individuals to candidates, transfers within a campaign, and contributions from one candidate to another will not be computerized;
- -- Individual contributions to PACs and party committees will similarly not be computerized, in addition to transfers to affiliates, and earmarked contributions;

-- The October Report on Financial Activity, analyzing the first 18 months of the 1985-86 election cycle is being cancelled.

In addition, the Commission no longer will finance the State Access Program in which it shares its data base with Secretaries of State.

The effects of the reduction in computerization will be a decrease in the availability and timeliness of information, and perhaps even in the accuracy of that information. Our brief experience so far as a result of the 1986 cuts indicates we will not have computer information available on a timely basis because the time for entry of data will double.

Despite the general reduction in our computerized disclosure program, the Commission will continue to meet its statutory mandate to index all reports filed with the agency and place them on the public record within 48 hours of receipt.

In order to continue to provide information to the public, the FEC will attempt, on a trial basis, to continue entry of political action committee (PAC) contributions to candidates, independent expenditures and communication costs by corporations and labor unions. This is a staff suggestion to preserve as much data as possible. In June, the Commission will assess this effort on the basis of timeliness and quality.

In addition to holding staff hiring below the approved level, the FEC has ordered reductions in Commissioner and staff travel, training, printing, publications, mailings, supplies, equipment purchases and administrative expenses. This will result in a serious curtailment of the FEC's outreach efforts, including workshops and the dissemination of information to the public. The FEC's National Clearinghouse on Election Administration will all but eliminate its outside contract for research and publications. The contract for court reporting of Commission executive sessions will also be terminated.

Supplemental Appropriation Request

When the 1986 Commission budget was initially before Congress, Members of both the House and Senate advised the agency to seek supplemental funding if absorbing the reduction attributed to the five percent pay cut proved a problem. On February 6, 1986, the Commission formally requested from Congress a supplemental appropriation of $282,000 -- partial restoration of lost funds.

Approval of the supplemental would permit the following:

1) Recapture of the data not computerized between February 1, 1986 and enactment;
2) Computer capacity would be brought back to its former level; and
3) State access would be resumed.

If the funds are not received, we will be unable to computerize important detailed data relating to the 1986 elections. While the information could still be retrieved manually, the quality of public disclosure will suffer.

The 1987 Request

The circumstances the Commission faces in 1987 are similar to those of 1986. With $12.8 million, we can maintain essential operations -- including disclosure. It is important to note that reductions in our planned activity will occur at $12.8 million. Anything below that level will mean drastic cuts in activity agency wide.

This revised request is $538,000 less than the $13,338,500 steady-state budget the Commission proposed last September. We believed that amount would be adequate to maintain 1987 activities at a level consistent with 1985 efforts and our plans for 1986. Of course, our plans for 1986 will not be realized. While $12.8 million will mean diminished operations, it will preserve the core program.

The reductions from our base level would be accomplished by cutting back travel, printing, equipment purchases and other overhead. Our outreach would remain restricted, but the $12.8 million would permit resumption of computerized disclosure services. The relatively full staffing complement could be achieved provided we hire only at the junior level in all cases. This would support restoration of coding and entry functions. We also expect to again offer Secretaries of State access to the computerized data base.

Conclusion

Mr. Chairman, the Commission was forced this year to react promptly to unanticipated budget reductions. We believe we have done so in the most responsible manner under the circumstances. We truly hope that funds will be available to exercise the option we left to resume full disclosure services.

It is because we have done so much with so little in previous years that we are being penalized heavily by budget cuts. In 1987, the Commission will continue to look at ways to improve its internal procedures. As mandated by statute, we will also be submitting to Congress our annual recommendations for legislative change, many of which would affect our operations. Funding of $12.8 million will give us limited flexibility to build on progress to date. A budget of less than $12.8 million is an alternative we hope not to face.

We appreciate what this Committee has done for the Commission in the past, and look forward to your continued support this year to assure that we can fulfill our legal mandate. Thank you.

1986 BUDGET STATUS

Mr. McGarry. I think it would be helpful, Mr. Chairman, to you and to the committee if I were to very briefly indicate to you, because of unusual circumstances that have occurred, exactly where we stand financially right now, 6 months into fiscal year 1986.

Senator Abdnor. All right

Mr. McGarry. Before we began this current fiscal year, 1986, OMB had cut our original budget request of $13,080,000 down to $12,756,000, a reduction of $324,000. Then the House and Senate, on the basis of the President's proposed pay cut, eliminated another $323,000, for a total of $647,000, Mr. Chairman, from our original request of $13,080,000. The original request was the steady-state level, with no changes: maintaining in a steady state all the programs that had been there the year beiore.

Both the House and Senate, as well as OMB, agreed on a personnel level of 245 full-time equivalent employees. That is where we were, Mr. Chairman, as we entered this current fiscal year, 1986.

In order to achieve the 245 personnel level, we would reduce our personnel down to approximately 234 in the offpeak season, then come up to approximately 250 in the peak season as we would approach the election.

In January of this year we were preparing for the current election cycle. We had allocated the money and were prepared to hire 15 people—coding, data entry, computer programming personnel, and 3 people for our Public Records Office.

On the eve of hiring those individuals, we received the Gramm-Rudman-Hollings notice of a 4.3 percent, or $535,000 cut. What we did, Mr. Chairman, was immediately freeze staff at the level we were at at that time of 234. We then made cuts totally across the board—travel, incentive awards, training, postage, equipment purchases, publications, printing, supplies, and certain administrative functions were also cut.

Even with all of that, cutting everything across the board, we were still short of the required Gramm-Rudman-Hollings goal of $535,000. We had nowhere to go but to drastically reduce our computerized public disclosure information. That, of course, Mr. Chairman, caused a furor, an uproar in the media, with Common Cause and by other organizations.

DATA REDUCTIONS

And what does all that mean in practical terms, Mr. Chairman? To put it as simply as I can, if you, for example, were to call or go to the Federal Election Commission and ask for computer printout of the financial activities of your opponent, right now the best we can do is 10 days. What would have been an immediate, overnight, turnaround is now a 10-day wait.

In addition, we do not enter into our computer data base individual contributions, candidate loans, or transfers. Beyond that, we have taken off line computerized data from 1976 through 1982. We have all of the public documents in hard copy. It is available, but we had to drastically reduce the computerized availability. Now, as a result of the cuts, we are reducing that information by eliminating some of the items that I just referred to you.

Over and above all of those things, we will not be able to publish probably one of the most popular things we do. That is the report on "Financial Activity," the summary report on all financial activity. For the first 18 months of this current election cycle, it will not be done.

I have gone into this kind of detail, Mr. Chairman, because I feel it is imperative that you understand the framework within which we are presenting our fiscal year 1987 budget request.

SUPPLEMENTAL APPROPRIATION REQUEST

Chairman Aikens referred to our request for an 1986 supplemental appropriation of $282,000. If we were to get that, Mr. Chairman, that $282,000 would only be used to restore the computer-related services that I just referred to. If we do not get that supplemental appropriation, the detailed campaign finance information for this current 1986 election cycle will probably never ever be computerized.

These are just the highlights of the sad state we are in at this particular moment. Now we are here to present to you the 1987 fiscal request and let me briefly summarize that.

FISCAL YEAR 1987 REQUIREMENTS

Our original request was $13.3 million. That is for no change, steady state, maintaining all programs and just continuing the status quo into this next fiscal year. OMB instituted a one-time rent reduction for fiscal year 1987 which was imposed across the board for Federal agencies and commissions. As a result, we were able to bring our request down to $13.1 million. OMB cut $300,000 off that, and we are now at $12.8 million for fiscal year 1987. We will have to make $300,000 in reductions below our base to arrive at the $12.8 million figure. Many of those reductions, Mr. Chairman, would be in the same areas that I outlined to you that resulted from receiving the Gramm-Rudman-Hollings notice—training, incentive awards, travel, postage, equipment purchases, publications, printing, supplies, and administrative expenses generally.

But it is imperative to know that that $12.8 million is the minimum level at which we can maintain our disclosure program. At the $12.8 million, we can maintain our 245 personnel level, and we can go back and get on line with the computerized public disclosure information that we had to cut.

If we do not get the $282,000 supplemental appropriation, we would need over and above the $12.8 million, $357,000 to recapture that historical data and to come up to speed on the computerized public disclosure information that had previously been available.

I want to say in conclusion, Mr. Chairman, that we have been able to do more with less, as a result of, in my opinion, the high morale we have at the Federal Election Commission, despite the demands and challenges that face the Commission.

CAMPAIGN SPENDING AND FEC WORKLOAD

I pointed out when I testified here prior to the last election, Mr. Chairman, that campaign spending would exceed $1 billion. It did that, Mr. Chairman, by 25 percent. Who dreamed a few years ago that we would have a Senate race, for example, that would exceed $16 million as we did in the last election and one exceeding $12 million and two exceeding $9 million and two others over the $5 million mark?

I do not quarrel with that. I am not finding fault with anything, but I am trying to point out to the committee that the fantastic leap into space, if you will, in campaign spending impacts on every facet and aspect of our operation across the board. It is only because of the high morale that we have been able to do more with less and increase our productivity.

I would like to point out that in 1980 we had a personnel level of 280. We are down today, as I sit here before you this afternoon, to 232.

Senator ABDNOR. What did you have at one time?

Mr. McGARRY. 280. As things are developing, in the forthcoming Presidential election we very likely under current circumstances will have more publicly funded Presidential candidates than we will auditors. As you know, Mr. Chairman, those are mandatory audits to protect the public risk. I think they are essential. I point out all of these things to show you the sad state of affairs that we are in at the present time.

We have been able to meet prior challenges. We finally were forced to buckle under and drastically reduce some of the computerized public disclosure information. But we have done all of this up until this time with a certain verve and spirit.

The New York Times wrote a feature article in January with glowing praise for our Public Records Office. Our hotline service, which received over 80,000 calls, Mr. Chairman, in the last Presidential election in my opinion is the best in all of government. No matter who calls, whether it is the President or John Q. Citizen, they are greeted with cordiality, competence and a responsiveness that is unequaled anywhere in Government.

We do this because people at the Federal Election Commission feel we play a very vital role in our entire electoral process. All you have to do is look around the world today; look at Angola, Nicaragua, Afghanistan, Haiti, and probably the most graphic example, the Philippines. The principle that is emerging from the problems these countries are experiencing is that the confidence of the people of any country in the integrity of their electoral process is really the rock-bed foundation of a stable Government and a free democratic society.

I submit to you respectfully, Mr. Chairman, the U.S.A. is no exception. We at the FEC feel very strongly that we make a major contribution to the integrity of our own electoral process. That is why we feel as strongly as we do that we are saddened to see our mission impaired, and the mandate of the law suffering.

The final point is that the $12.8 million figure, Mr. Chairman, that we are seeking for fiscal year 1987 is the OMB Gramm-Rudman-Hollings figure that was sent to the Congress by the White House. It is absolutely imperative that we get at least that amount of money.

Thank you very much, Mr. Chairman.

Senator ABDNOR. Thank you

What did you tell me the $12.8 million gives you for the number of employees?

Mr. McGARRY. We have 280.

Senator ABDNOR. No; you do not have 280.

Mr. McGARRY. Right now we are down to 232.

Senator ABDNOR. You started out with 245.

Mr. McGARRY. 245 is the full-time equivalent that the OMB, the House and Senate agreed upon both for our current 1986 year and for our 1987 fiscal year request; 245 is the full-time equivalent employees.

Senator ABDNOR. You just said you could use more money, but will 245 let you run an efficient office?

Mr. McGARRY. We will sacrifice; we will not have the outreach and a lot of other programs that we feel are vitally needed to make the law work properly. We are cutting in various areas across the board. The Office of General Counsel and our Audit Division are suffering very badly. But we feel we can fulfill the basic mission in a reduced state at $12.8 million. If we wanted to restore some of the programs which we all feel very strongly should be restored, we would need money over and above the $12.8 million.

Senator ABDNOR. And $12.8 million was OMB's figure.

Mr. McGARRY. Yes.

Senator ABDNOR. The House supplemental, are your funds in there, do you know?

Mr. McGARRY. We made the request and there has been no action on it.

Senator ABDNOR. Did OMB support you on that?

Mr. McGARRY. OMB has not supported us on that $282,000 supplemental.

Senator ABDNOR. I went through this with Mr. Hatfield. We are in a tougher bind than the House. For some dumb reason we have a different set of rules. And if we put money in, it has to come out somewhere on our side. That is causing a lot of concern. I just tell you that. I have to go into it deeper myself, but it will not be easy. I am not trying to scare you, but we had better get OMB or somebody on our side to help us figure out how to do it.

I assume you got more requests today than you had 5 years ago or when you had the 280. Is that a correct statement?

Mr. McGARRY. Yes, absolutely.

Senator ABDNOR. How many requests do you handle in a year?

Mr. McGARRY. Requests in our Public Information Office?

Senator ABDNOR. Yes.

Mr. McGarry. In the last election, Mr. Chairman, we had over 80,000 requests.

Senator Abdnor. What kind of requests?

Mr. McGarry. That leaped up from 60,000. Every facet and aspect of our operation is impacted upon by this phenomenal increase in campaign spending. Chairman Aikens has the chart right here to answer that question more directly and more specifically

Ms. Aikens. Inquiries in 1981 of the Public Records Office totaled 22,820, and in fiscal year 1985 31,270. Total inquiries for public records, press, and information were 73,500 in 1981 and 104,900 in 1985. They were as high as 121,500 in fiscal year 1984, which took in the election period.

Senator Abdnor. I realize it varies from year to year and it is different in a Presidential year. Are there more and more reports coming in? Candidate numbers do not——

Mr. McGarry. Absolutely. The reports reviewed in 1981 were 32,000; they went up to 57,000. Compliance cases opened went from 112 in 1981 to 360. That is the way it is across the board in every facet and aspect of our operation.

We have pending, because we have exclusive civil jurisdiction in the courts, Mr. Chairman, approximately 50 cases in Federal courts throughout the United States. Eight of those are in the Federal circuit courts of appeal; two of them are in the U.S. Supreme Court, and the balance are in the U.S. District Courts throughout the country.

In every facet and aspect of our operation there has been that same phenomenal leap in activity that stems directly from the increase in campaign spending. In 1988, the next Presidential election, nobody seriously disputes, that I am aware of, that we are going to have a minimum of 20 publicly funded Presidential candidates. This will be the first election since, I believe, 1968 that an incumbent will not be a candidate for reelection.

That in and of itself is going to pose tremendous problems in the form of activity across the board at the Federal Election Commission.

Senator Abdnor. For the record, would you provide a detailed accounting of how you apply the Gramm-Rudman cuts for us?

Mr. McGarry. I would be glad to, Mr. Chairman.

[The information follows:]

MEMORANDUM FROM JOHN C. SURINA, STAFF DIRECTOR, FEDERAL ELECTION COMMISSION

AGENDA DOCUMENT NO 86-13. APPROVED BY 6-0 VOTE

TO: THE COMMISSION

FROM: JOHN C. SURINA, STAFF DIRECTOR

SUBJECT: FISCAL 1986 BUDGET REDUCTIONS AND AMENDMENTS TO OUR '86 MANAGEMENT PLAN

DATE: JANUARY 24, 1986

Over the past two weeks, the Finance Committee has met repeatedly in extended sessions to assess the impact of the automatic cuts imposed by the Gramm-Rudman-Hollings Act, debate alternative approaches to adapt to those reductions, and to devise a rational recommendation for consideration by the Commission. What follows is a brief recounting of those meetings.

SUMMARY OF THE CUTS

In addition to the 4.3% reduction in budget authority flowing from the operation of the Gramm-Rudman-Hollings Act, this agency also took a 5% cut in its personnel compensation budget under the false assumption that there was to be a government-wide pay cut this year. We share this distinction of taking two cuts with other agencies covered by the Treasury-Postal Appropriation. The delay in our relocation from 1325 K to 999 E has saved us some funds, but an amount inadequate to offset either of the two reductions, much less their combined impact.

Compounding the problem is the fact that we are already one third into the fiscal year; leaving us only two thirds of a year to absorb the reductions. Notwithstanding the fact that our SLUC (Rent) payments for the first quarter were at the old (1325 K) rates, that there was a delay in relocating the Commission and that our first quarter staffing was, as planned, roughly eleven under ceiling, we expended almost the full quarter of the amount authorized under the year-long Continuing Resolution.

The math show below indicates the problem better than text. Clearly, this is a severe cut:

	$12,756,000	Consensus steady-state budget
less	323,000	Reduction attributed to pay cut that wasn't
	$12,433,000	Year long Continuing Resolution
less	535,000	Gramm-Rudman-Hollings reductions
	$11,898,000	Current Budget Authority

Estimated SLUC (Rent) savings:

	$ 1,542,000	Estimate as in our '86 Budget Request
less	1,305,000	Current estimate
	$ 237,000	Projected Savings

Reduction recap:

	$ 323,000	Reduction attributed to pay cut that wasn't
plus	535,000	Gramm-Rudman-Hollings reductions
	$ 858,000	Total reductions
less	237,000	SLUC savings
	$ 621,000	Effective Cut

APPROACH

Several considerations guided our deliberations. First, across-the-board reductions within the agency could be sustained only to a limited degree. After a certain point, the performance of all activities degrades without regard to statutory or managerial priorities. Consequently, given the severity of these reductions, those activities not expressly mandated by the law would have to be targeted for more severe cuts.

Second, all opportunities for rational reductions in non-personnel costs would be exhausted before personnel reductions would be addressed. Cuts in non-personnel categories would have to be applied in a manner consistent with the aforementioned priority to salvage mandated activities. For example, totally eliminating travel monies would hit directly at our mandated enforcement and audit programs; but some travel cuts can be sustained in our outreach and disclosure programs.

Third, to the extent that we would have to reduce the personnel budget, we sought to achieve those cuts by means other than reduction-in-force or furlough. Since our non-personnel expenses comprise only 30% of our budget, it was clear the cuts would reach our personnel compensation budget. Rather than compound the impact of the cuts by either RIF or furlough, which entail additional costs, we first sought to restrain or freeze hiring in those programs not expressly mandated by law. This latter ground-rule tended to narrow the focus to our disclosure program since our cyclical hiring for the '86 election in Data Systems and Public Disclosure has not yet begun. As mentioned earlier, we purposely held down staffing in the first quarter of the fiscal year in order to sustain a major staffing up of lower level employees as we approached election day. The attached graph indicates how we would have expended our staff-year ceiling per our original management plan.

RECOMMENDATIONS

The attached revised management plan outlines in dollars within object class where the Finance Committee believes the cuts should be sustained. Beyond a drastic across-the-board cut in all non-personnel expense categories, the Committee addressed specific activities within the several divisions of the Commission in keeping with the aforementioned criteria.

In dollar terms, we propose making up the $621,000 shortfall by taking $226,000 out of our personnel compensation budget and $395,000 from non-personnel expenses. Within the latter, roughly $215,000 will come from contract authority and some $180,000 from general support items such as travel, supplies, training, and the like.

Our first step is to freeze employment at our current level of 234; a full eleven staff years under our full-time-equivalent (FTE) ceiling of 245. We will not, as planned, hire the temporary coders in the Data Division, and will fill vacancies in other Divisions only on an as-justified, case-by-case basis. The bulk of the cut absorbed within the personnel compensation budget will therefore be borne by Data Systems.

The $180,000 reduction in general support will be borne equally throughout the Commission. Details are provided in the attached charts. The major focus of these reductions was on the Travel, Training, Printing, Publications, Postage, Supplies, Equipment Purchases and Administrative Expenses object classes. As a result, the outreach programs; workshops, printed publications, as well as mass mailings, will be significantly curtailed.

The general impact will be felt by all offices: training is frozen; incentive awards are eliminated; supply purchases reduced; and only essential equipment will be purchased or replaced on a strict priority basis. The planned cyclical replacement of worn and old equipment has been abandoned for FY 1986.

$62,500 of the reduction in contract authority will be achieved by deferring the award of our contract to update our Election Case Law publication and reducing the amount of the absentee voting contract. We also propose cancelling our court reporter service contract.

The balance, roughly $150,000, is derived by reducing the computerization of the itemized information filed by political committees for the 1986 cycle. We will retain our 48-hour capture of summary information off the reports (our "Pass I" capture); but will cancel the capture of much of the information we heretofore took off the schedules to the reports (Pass III).

To achieve the $150,000 in savings from reduced ADP related contract costs, the following actions are necessary:

- No outside Data Entry (contract terminated)
- 18 Terminals eliminated (26%)
- 20% Reduction in computer storage
- 25% Reduction in computer memory

The impact of the reduced staffing and contract capabilities will be as follows:

- Removal of the 1976, 1978, 1980 and 1982 Data Bases from on-line availability.
- Elimination from the 1986 data base of:
    - Individual contributions
    - Contributions from unauthorized to party committees
    - Transfers
    - Loans
    - Earmarked contributions
    - Joint Fundraising activity
- Elimination of Data Entry efforts with regard to the MUR index and MUR.
- Transference of responsibility for entry of Miscellaneous, RFAI transactions and Ballot Lists to RAD.
- Cancellation of the October Reports on Financial Activity, the major pre-election RFA (covering 1st 18 months of election).
- Charging States to access the Data instead of providing free service.
- Revising the Pass III entry and coding process.

The effect of the reductions in Data will be as follows:

- Timeliness
    The median frame required for data entry could double.
- Accuracy
    The accuracy of detailed information will be reduced because a less expensive method of data entry will be used.

- Completeness
  Reduced availability of detailed information.

- Remaining Data Available
  Committee contributions to candidates
  Independent expenditure activity
  Communication costs filings (Packwood)

Cutting back our automated disclosure program is a radical action; however, it is consistent with the ground-rules we established for ourselves.

- This activity is not expressly mandated by law. The statutory mandate to index and compile the information within the reports is, in gross terms, satisfied by our Pass I entry.

- This activity could be fully restored for the '88 election cycle. Unfortunate as loosing portions of our '86 cycle data base may be, we can resume capturing the eliminated itemized information at a later date with minimum start-up costs. This, of course, assumes future funding so permits.

- The additional staff who would have been assigned this work have not yet been hired. We are just at that point in our cyclic hiring where we would start bringing on coders for the waves of information flowing in on the '86 cycle. It is far less expensive, both in economic and human terms, to not hire rather than to fire. If we do not hire the personnel who would be assigned Pass III data related duties, we can hire against at least some of the future vacancies elsewhere in the Commission.

The Finance Committee seriously considered eliminating all itemized disclosure information from the data base, retaining only the summary information now captured under Pass I.

Our data processing staff, however, have requested the opportunity to attempt to salvage PAC activity and Communication Costs without the contract and temporary employee resources normally available for this work. No guarantees were tendered by staff nor imposed by the Finance Committee on this attempt.

We will reassess the viability of this partial salvage effort in June. If the timeliness and quality of the partial data capture meet minimum expectations, we will continue this level of effort for the balance of FY 1986; if not, all itemized data entry will be discontinued.

ADVERSE IMPACT

Over the past several years, this agency has made great strides in improving the accuracy, timeliness, comprehensiveness of, and access to, our disclosure information. Reversing that trend is a severe step not lightly proposed. Many members of the general public, the press corps, academics and committees themselves have come to rely upon the availability of this detailed information. Absent this data capture, the public will be denied the the level of detail available in the past. The timeliness and accuracy of the data will be degraded. Similarly suspended will be our subsidy of the State Access Program whereby we have shared our data base with Secretaries of State to ease their compliance with Section 439. We do not now know if the states can pay for the communication and machine-time costs themselves. Finally, given the limitations of the data base, it is difficult to project how many paying customers subscribing to our Direct Access Program will cancel their subscriptions.

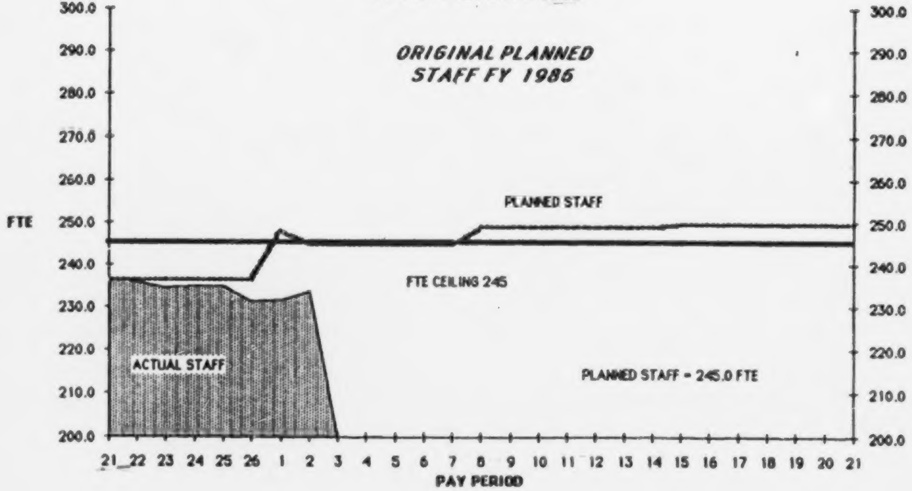
After a couple years of progress in rebuilding the research and publication capabilities of the Clearinghouse, we have again been compelled to withhold the contract authority necessary to update stale reference tools such as the Election Case Law which was programmed for award this year.

One administrative program heavily impacted will be the contract for preparation of executive meeting transcripts, which will be terminated March 1, 1986. After that date, all Sunshine Act requests for discussions on closed enforcement matters will be satisfied by the provision of audio tapes of the meetings.

Finally, the reductions in all other non-personnel object classes, while saving some immediate out-of-pocket expenses, will impinge on proper program execution and entail long term inefficiencies For example, the drastic reduction in our travel budget will certainly impact our outreach and thus deny to some within the regulated community the instruction necessary to keep them abreast of their responsibilities under the law. The virtual elimination of all training funds and incentive awards can be sustained for a short period; but a prolonged dearth of monies in these categories will obviously lead to a degradation in staff productivity.

I recommend full Commission adoption of the proposals as approved by the Finance Committee.

PLANNED FTE FOR FY 1986



ACTUAL VS. PLANNED FTE AS OF 1/21/86

OBLIGATIONS TO DATE BY QUARTER
FISCAL YEAR 1986 (9561600)

BJ	DESCRIPTION	ANNUAL	DECEMBER 31.	1985
LASS		BUDGET	OBLIGATED	%
1.1	PERMANENT POSITIONS	7.329.448	1.858.360	25.35
1.3	TEMPORARY POSITIONS	80.321	19.333	24.07
1.6	CONSULTANTS			.00
1.7	INTERMITTENT EMPLOYEES	1.034	1.034	100.00
1.8	WITNESSES	5.000	1.223	24.46
2.0	OVERTIME	26.987	11.646	43.15
3.2	TERMINAL LEAVE	12.812	12.811	99.99
4.0	PERSONNEL BENEFITS	853,398	215,668	25.27
5.1	CASH AWARDS	20.000	3.944	19.72
6.0	BNFTS - FORMER EMPLOYEES	10,000		.00
TOTAL	PERSONNEL COMPENSATION	8.339.000	2,124,019	25.47
1.1	TRAVEL	160.848	36.941	22.97
1.2	MOTOR POOL	5.200	1.290	24.81
2.1	TRANS. OF THINGS	1.603	1,306	81.47
3.1	GSA SPACE RENTAL	1.542.000	145.825	9.46
3.2	COMM. SPACE RENTAL	20,000	1.708	8.54
3.4	EQUIPMENT RENTAL	233,000	64.894	27.85
4.0	PRINTING	267.086	69.873	26.16
4.2	MICROFILM PRINTS	40,500	25,200	62.22
5.0	TRAINING	27.955	4.827	17.27
5.1	ADMIN. EXPENSES	73.732	21.834	29.61
5.2	SUPPORT CONTRACTS	943.000	202,250	21.45
6.1	SUPPLIES/MATERIALS	150,000	33.454	22.30
6.8	PUBLICATIONS	69.437	57,653	83.03
7.1	TELEPHONE-LOCAL	127,500	32.875	25.78
7.2	LONG DISTANCE TOLLS	3.500	1.021	29.17
7.3	TELEGRAPH	1.139	39	3.42
7.4	POSTAGE	118.000	29,400	24.92
7.6	TELEPHONE INTERCITY	197.000	49.245	25.00
9.2	RECURRING SERVICES	51.500	12,283	23.85
9.3	NON-RECURRING SERVICES	1.500	700	46.67
1.1	EQUIPMENT PURCHASES	59,500		.00
0.1	LAPSE			.00
0.2	RESERVE			.00
TOTAL		12,433,000	2.916,637	23.46

REVISED MANAGEMENT PLAN FY 1986

MANAGEMENT PLAN FY 1986 ANALYSIS 1/24/86	ORIGINAL ANNUAL BUDGET	REVISED ANNUAL BUDGET	DIFFERENCE
SALARIES & BENEFITS	8,607,000	8,372,627	-234,373
OVERTIME	20,000	28,344	8,344
WITNESSES	5,000	4,892	-108
CASH AWARDS	20,000	20,000	0
UNEMPLOYMENT	10,000	10,000	0
TOTAL PERSONNEL	**8,662,000**	**8,435,863**	**-226,137**
TRAVEL	160,848	105,748	-55,100
MOTOR POOL	5,200	5,200	0
TRANS. OF THINGS	1,603	1,603	0
GSA SPACE	1,542,000	1,305,000	-237,000
COMMERCIAL SPACE	20,000	20,000	0
EQUIPMENT RENTAL	233,000	243,000	10,000
PRINTING	267,086	239,586	-27,500
MICROFILM PRINTS	40,500	40,500	0
TRAINING	27,955	4,955	-23,000
ADMIN. EXPENSES	73,732	68,569	-5,163
SUPPORT CONTRACTS	943,000	730,500	-212,500
ADP CONTRACT	764,000	683,000	-81,000
DATA ENTRY	84,000	15,000	-69,000
C. HOUSE	95,000	32,500	-62,500
OTHER	0	0	0
SUPPLIES & MATERIALS	150,000	125,000	-25,000
PUBLICATIONS	69,437	60,337	-9,100
TELEPHONE--LOCAL	127,500	127,500	0
LONG DISTANCE TOLLS	3,500	3,500	0
TELEGRAPH	1,139	1,139	0
POSTAGE	118,000	100,000	-18,000
TELEPHONE INTERCITY	197,000	197,000	0
RECURRING SERVICES	51,500	51,500	0
NON-RECURRING SERVICES	1,500	1,500	0
EQUIPMENT PURCHASES	59,500	30,000	-29,500
LAPSE	0	0	0
RESERVE	0	0	0
TOTAL NON-PERSONNEL	**4,094,000**	**3,462,137**	**-631,863**
TOTAL COMMISSION	**12,756,000**	**11,898,000**	**-858,000**

GRAMM-RUDMAN-HOLLINGS REDUCTIONS 1/24/86

GRAMM-RUDMAN-HOLLINGS SUMMARY OF REDUCTIONS NECESSARY
1/24/86

OBJECT CLASS	FY 85 ACTUAL	ORIG. FY 86	REDUCTION	FINAL FY 86	OBLIG TO DATE
TRAVEL	153,961	160,848	55,100	105,748	36,946
PRINTING	236,395	267,086	27,500	239,586	69,873
PUBLICATIONS	80,161	69,437	9,100	60,337	57,654
POSTAGE	103,057	118,000	18,000	100,000	29,400
TRAINING	28,568	30,000	23,000	7,000	4,827
SUPPLIES	137,300	150,000	25,000	125,000	33,454
EQUIPMENT PURCHASES	203,000	59,500	29,500	30,000	0
ADMIN EXPENSES	73,944	68,404	5,163	63,241	16,507
C. HOUSE CONTRACTS	145,984	95,000	62,500	32,500	0
DATA ENTRY CONTRACT	93,752	84,000	69,000	15,000	21,000
ADP CONTRACT	713,727	764,000	81,000	683,000	181,250
EQUIPMENT TENTAL	201,505	233,000	-10,000	243,000	64,894
TOTAL REDUCTION:			394,863		
LESS ADP & DATA ENTRY:			-150,000		
PRELIM. REDUCTION:			244,863		

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. I think I have already, without looking, asked these questions but I will have a few for the record, if you do not mind.

Mr. MCGARRY. Not at all.

[The following questions were not asked at the hearing but were submitted to the Commission for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question. Before we get to your Fiscal 1987 request, let us touch on the supplemental you are seeking. First, how will this funding be used? Secondly, what would happen if this supplemental is not provided? Would you have to RIF people? How would this impact the FEC in future years?

Answer. The $282,000 requested in the Supplemental Appropriation for FY 1986 would be used to resume the coding and entry of detailed, itemized campaign finance information from disclosure documents into the FEC disclosure data base. This information was curtailed as of January 30, 1986, due to the Gramm-Rudman-Hollings reductions.

In effect, the supplemental would allow the FEC to restart this data capture, and to recapture the data for the FY 1986 election cycle which has been lost so far. It would provide for the 12 positions in the data coding and entry staff which were not filled, and would restore data entry contract funds which had been eliminated.

Receipt of the supplemental would ensure that the detailed coding and entry staff would be in place at the start of FY 1987 and that the 1986 election cycle data would be recaptured.

If the funding is not received, the FEC would not have to RIF people nor make further reductions: the funding is restorative. However, failure to receive the funding means that the 1986 election cycle data effectively has been lost. The FEC request of $12,800,000 for FY 1987 would restore funds to restart the program, but would not allow recapture of the lost data for the 1986 election.

Assuming the FEC receives adequate funding in FY 1987 and future fiscal years, the detailed data entry and coding would be received for the 1988 election cycle and beyond. However, unless additional funds were appropriated specifically for recapture of the lost data in some future years, the 1986 election cycle data is lost forever.

Question. The Commissions original request for FY 1987 totaled $13.3 million. The administration is requesting $12.8 million. What had you planned to do had you gotten the $13.3 million?

Answer. The chart which follows shows the reductions from the Commission's original request of $13,338,500 to $12,800,000. Of the reduction, $232,000 represents the one-time reduction in SLUC rates imposed by OMB on GSA for FY 1987 and is "painless." The remaining $306,500 reduction, however, has an adverse impact on the FEC's programs.

REDUCTIONS DUE TO GRH 2/6/86								
$ IN 000's			**FY 1986**	**MANGMT.**	**PLAN**			
OFFICE	STAFF YEARS	PERSONNEL	TRAVEL	($11,898K) TRAINING	PRINTING	PUBLI- CATIONS	ADMIN. EXPENSES	SUPPORT CONTRACTS
COMMISSION	0.6	38.8	-10.1	0.2	0.0	0.1	0.0	0.0
STAFF DIR.	0.3	20.7	-4.8	-10.8	-0.7	0.7	10.4	0.0
ADMIN.	0.5	-34.3	0.0	-1.2	-5.6	-1.0	-17.9	0.0
AUDIT	-2.3	-47.4	-10.0	-2.5	0.0	-0.5	-0.6	0.0
INFOR.	-0.6	-5.7	-17.5	-1.6	-20.5	-1.0	-0.5	0.0
C. HOUSE	-0.3	3.2	-2.5	-1.0	3.5	-2.8	0.0	-62.5
OGC	0.4	19.1	-0.4	-2.3	-5.1	-3.0	-1.8	0.0
DATA SYS.	-6.4	-88.0	0.0	-1.9	5.4	-0.6	-6.6	0.0
DISCLOSURE	-1.5	-7.8	-8.3	-1.2	0.0	-0.4	-0.5	0.0
RAD	-2.0	-92.8	-0.4	-2.5	0.0	-0.5	-0.5	0.0
RELOCATE	0.0	0.0	0.0	0.0	0.6	0.0	7.8	0.0
SUBTOTAL	-11.3	-194.2	-54.0	-24.8	-22.4	-9.0	-10.2	-62.5
Witnesses		-0.1						
Overtime		12.6						
Cash Award		0.6						
Merit Pay		-45.0	(in salaries)					
Term. Lv.		0.0	(in salaries)					
Unemploy.		0.0						
TOTALS	-11.3	-226.1	-54.0	-24.8	-22.4	-9.0	-10.2	-62.5
Staff Dir.	0.0	9.9	-0.5	-1.0	0.7	-0.5	10.6	0.0
P & M	0.0	in SDO	0.0	-1.5	0.0	-0.4	-0.5	0.0
Personnel	0.0	5.1	-1.9	-6.2	0.3	2.0	-1.2	0.0
Press	0.1	5.7	-2.0	-1.0	-0.7	-0.8	1.5	0.0
Cong. Liais.	0.0	in SDO	-0.4	-0.5	-1.0	0.4	0.0	0.0
Comm. Sec.	0.2	in SDO	0.0	-0.6	0.0	0.0	0.0	0.0
SDO TOTAL	0.3	20.7	-4.8	-10.8	-0.7	0.7	10.4	0.0

			FY 1986	MANGMT.	PLAN			$ IN 000'S
	MICROFILM			($11,898K)			OTHER	
OFFICE	PRINTS	ADP	DATA ENTRY	MAILGRAMS	COMM SPACE	TRANS. OF THINGS	See next Pg	TOTALS
COMMISSION	0.0	0.0	0.0	0.0	0.0	0.0	0.0	29.0
STAFF DIR.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	15.5
ADMIN.	0.0	0.0	0.0	0.0	**-0.6**	**-0.2**	**-299.5**	**-360.3**
AUDIT	0.0	0.0	0.0	0.0	0.0	0.1	0.0	**-60.9**
INFOR.	0.0	0.0	0.0	0.0	**-0.3**	0.0	0.0	**-47.1**
C. HOUSE	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**-62.1**
OGC	0.0	0.0	0.0	0.0	0.0	0.7	0.0	7.2
DATA SYS.	0.0	**-81.0**	**-69.0**	0.0	0.0	0.0	0.0	**-241.7**
DISCLOSURE	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**-18.2**
RAD	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**-96.7**
RELOCATE	0.0	0.0	0.0	0.0	0.0	0.8	0.0	9.2
SUBTOTAL	**0.0**	**-81.0**	**-69.0**	**0.0**	**-0.9**	**1.4**	-299.5	**-826.1**
Witnesses								**-0.1**
Overtime								12.6
Cash Award								0.6
Merit Pay								**-45.0**
Term. Lv.								0.0
Unemploy.								0.0
TOTALS	**0.0**	**-81.0**	**-69.0**	**0.0**	**-0.9**	**1.4**	**-299.5**	***-858.0***
Staff Dir.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	19.2
P & M	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-2.4
Personnel	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-1.9
Press	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.7
Cong. Liais.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-1.5
Comm. Sec.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.6
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**15.5**

FY 1986 MANAGEMENT PLAN - ADMIN DIVISION	**($11,898K)**
OTHER COSTS	$ IN 000's
MOTOR POOL	0.0
GSA SPACE RENTAL	**-237.0**
EQUIPMENT RENTAL	10.0
SUPPLIES & MATERIALS	**-25.0**
TELEPHONE-LOCAL	0.0
LONG DISTANCE TOLLS	0.0
TELEPHONE-INTERCITY	0.0
POSTAGE	**-18.0**
RECURRING SERVICES	0.0
NON-RECURRING SERVICES	0.0
EQUIPMENT PURCHASES	**-29.5**
TOTAL	**-299.5**

In many areas, the reductions are similar to the cuts made by the Commission due to Gramm-Rudman-Hollings in FY 1986. The difference is that the FEC would restore the capture of detailed data coding and entry for the disclosure data base in FY 1987 at the $12,800,000 level.

While the details of the cuts would be determined by the Commission when it develops the FY 1987 Management Plan, the areas effected are: travel, training, printing, equipment, publications, and administrative support. In general, these cuts impact on the outreach, candidate assistance, and informational programs and on basic support for all Commission programs.

While $12,800,000 would support 245 FTE, all new hires would have to be at the entry level, regardless of level of employee lost. Incentive awards would also be reduced. Furthermore, while staffing levels would be maintained, the administrative base would be severely impacted for the second straight year. Similar reductions to that base in previous years in response to reduced budgets had an adverse impact upon the FEC administrative base, which was revitalized in FY 1984 and FY 1985. These cuts risk a renewed degradation of that base.

The Commission strongly emphasizes that $12,800,000 represents a marked reduction from our base line budget request for FY 1987. It therefore represents our contribution to the Gramm-Rudman-Hollings reductions.

Question. It appears that you will have some vacancies as you approach the filing season. How will this impact your ability to process your workload?

Answer. The major impact of the FEC's vacancies is felt in the disclosure programs: 15 "seasonal" or "cyclical" positions were purposefully not filled as the result of Gramm-Rudman-Hollings. These positions are in the Data Systems (data coding, entering, and programming) and Public Disclosure Divisions.

Several vacancies have not been filled throughout the Commission, mostly in the clerical area. Therefore, clerical support for all programs has been degraded. Furthermore, the Reports Analysis Division is operating 2.0 FTE below planned levels, and the Audit Division is at 19 positions versus a planned 24.

While no major degradation of other programs has occurred, the Commission will not be able to continue to make improvements in the timeliness of many operations; indeed, as the election cycle of activity peaks some programs may suffer some delays due to clerical and other vacancies.

Nevertheless, the only serious program impact to date has been on the detailed disclosure information. This is, of course, a major blow to the Commission's desire to make the widest possible public disclosure of campaign finance information.

Question. It appears you are cutting back on come automated data availability. Has this been done yet? What has the public reaction been?

Answer. Yes; cutbacks were effective as of March 1, 1986. While candidate and political committee reports are still available on microfilm for public review and copying, the computerization of itemized information filed by political committees has been reduced. While gross receipts and disbursements are still being entered, the data entry contract has been terminated, computer storage has been reduced by 20 percent and computer memory by 25 percent.

The losses have resulted in the following:

- All information from election cycles prior to 1984 has been taken off line;
- Contributions from individuals, transfers within a campaign, and contributions from candidates to other candidates, earmarked contributions through PACs, and some other data are no longer being entered from reports;
- The October Report on Financial Activity, which would have provided an analysis of campaign finance activities for the first 18 months of the 1985-86 election cycle, has been cancelled.

The public reaction has been expression of great concern. While the cuts were structured to attempt to make programs more easily recoverable should additional funding become available, the immediate impact has been delay in obtaining certain information and other data being taken off line and only available through manual search of records.

Our disclosure program has been much praised for its speed, accuracy and comprehensiveness. We share the public disappointment at having to cut these important services.

Question. Have you gotten completely settled in your new quarters? How did the move go?

Answer. We are finally settled in our new quarters at 999 E Street, N.W. and are quite satisfied. The Commission had hoped to move in March 1985. Delays in obtaining and preparing the space resulted in part of the Commission moving in November 1985, and the remainder not relocating until February 1986. (Because of the rent savings from delay in the move, the Commission returned $340,000 in unused funds to the Treasury at the end of FY 1985.) The actual move itself went without major difficulty. As could be expected with any undertaking of this magnitude, minor problems and oversights are still being corrected.

The new facility remedies the problems faced at the Commission's old quarters. There is safe and adequate space for Commission staff, and particularly the public. Some outdated equipment has been replaced and previously blighted areas have been re-furnished.

Question. Data is the essence of your business. To make that data available it must be entered. How does this budget affect data entry?

Answer. As noted in responses to earlier questions, the Commission was forced to reduce data entry in FY 1986 to respond to the budget cuts attributable to the proposed 5 percent pay cut and the 4.3 percent Gramm-Rudman-Hollings sequestration. The $12.8 million request for FY 1987 will permit resumption of prior levels of data entry, although additional funds would be required to recapture the information not entered in FY 1986.

SUBCOMMITTEE RECESS

Senator ABDNOR. I am well aware you have not exactly been prospering from our budgets in the past. So I will not bother with any more questions today.

And thank you very much for appearing.

Ms. AIKENS. Thank you, Mr. Chairman.

Mr. MCGARRY. Thank you. Nice to see you as usual, Mr. Chairman.

Senator ABDNOR. Thank you very much.

I want to thank all of our witnesses for their participation in today's hearing. I do not believe there is any further business to come before the subcommittee at this time. So, we will stand in recess until tomorrow at 10 a.m., when we will hear from the Director of the Office of Management and Budget.

[Whereupon, at 3:25 p.m., Wednesday, April 9, the subcommittee was recessed, to reconvene at 10 a.m., Thursday, April 10.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

THURSDAY, APRIL 10, 1986

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:08 a.m., in room S-126, the Capitol, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, and DeConcini.

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

STATEMENT OF JAMES C. MILLER, III, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

ACCOMPANIED BY JEFFREY A. EISENACH, EXECUTIVE ASSISTANT TO THE DIRECTOR

PREPARED STATEMENT

Senator ABDNOR. The subcommittee will come to order.

Today we will continue our 1987 budget hearings with testimony on the budget for the Office of Management and Budget from James C. Miller, the OMB Director.

Nice to have you here before us. I am sure you know since you have appeared before many, many committees that your entire statement will be made a part of the record.

I understand you have a heavy schedule this morning so you can proceed.

Mr. MILLER. Thank you, Mr. Chairman.

We have a statement and a series of papers and background information we will submit to you.

Senator ABDNOR. Fine. It will be part of the record.

Mr. MILLER. OK. Thank you, sir. I have a short statement.

Senator ABDNOR. Go right ahead.

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Mr. MILLER. It is a pleasure, of course, to appear before you today to talk about the OMB request. We have a separate short statement also on the Office of Federal Procurement Policy. With your permission, we would like to submit it for the record.

Senator ABDNOR. Without objection.

[The statement follows:]

STATEMENT OF JAMES C. MILLER, III

Mr. Chairman and Members of the Subcommittee: it is a pleasure to appear before you today to discuss the FY 1987 budget request of the Office of Management and Budget. I also have a separate statement about the Office of Federal Procurement Policy, which, with your permission, I'd like to submit for the record.

OMB's budget request for FY 1987 is for $39,682,000 -- in nominal terms about 11 percent above our appropriation for FY 1986, after the Gramm-Rudman-Hollings sequester. However, the request -- again, in nominal terms -- is only 2 percent above our operating level for FY 1985. I believe our request for FY 1987 represents a prudent level of funding which will enable us to continue providing the President with the necessary support to participate effectively in an increasingly complex budget process and to carry out his numerous management and regulatory initiatives.

About 86 percent of OMB's budget is for personnel compensation and benefits (67 percent), standard level user charges (SLUC; 13 percent), printing of the President's Budget and related documents (3 percent), and text and data processing support (3 percent). An additional 3 percent is for telephone service, postage, utilities, and rental of equipment. The remainder covers staff travel and training, background investigations, ADP and other equipment purchases, and office supplies.

Mr. Chairman, as you know, in recent years OMB has been appropriated less than the President had requested. In real terms, OMB's FY 1986 budget authority (after the sequester) is approximately 14 percent below the level appropriated in FY 1981. Over two-thirds of this reduction occurred in FY 1986 -- because of the sequester, but also because (in nominal as well as real terms) the appropriation for FY 1986 was actually below the appropriation for FY 1985.

We have absorbed these reductions in two ways. In the long run, we have made wise investments in productivity-enhancing automated data processing systems and implemented a variety of cost-saving measures such as limiting optional travel, reducing the amount of space occupied by OMB staff, and using new technology to reduce printing costs. These improvements in overall efficiency have allowed OMB to continue performing its mission while using fewer resources.

In the short run we have taken a number of cost-saving steps, the most important of which is that we have imposed a near freeze on new hiring. Currently, over 60 positions are vacant -- positions such as the Associate Director for National Security and International Affairs, the Chief of our Water Resources Branch, and the Deputy Chief of our Budget Preparation Branch. (See Attachment A.) In addition, we have: reduced our budget for equipment purchases and put off plans for replacing our faltering word processing system; limited our budget for cash awards for employees; and reduced the amount we had budgeted for overtime.

These cutbacks, I should add, have been imposed in the face of a significantly increased overall workload. We expect that nearly 40,000 work hours will be expended during FY 1986 in implementing the new processes mandated by Gramm-Rudman-Hollings (G-R-H), and about 15,000 hours in FY 1987. G-R-H has also increased our printing costs significantly, and will continue to do so in the future.

Mr. Chairman and Members of the Subcommittee: Congress and the Administration have embarked together on a path to eliminate the deficit by 1991. Meeting this goal will require careful analysis and extensive coordination. We must eliminate those government programs that are not justified, pare those that are bloated, preserve those that are warranted, and increase those that are of highest priority. And, we must continue to implement management and regulatory reforms to ensure government uses the minimum resources necessary to serve our citizens and does this in a way that poses the least threat to their well-being.

Mr. Chairman and Members of the Subcommittee: that completes my prepared statement. I shall be happy to address any questions you might have.

OFFICE OF FEDERAL PROCUREMENT POLICY

Mr. Chairman and Members of the Subcommittee: I appreciate this opportunity to appear before you to discuss the FY 1987 appropriation request for the Office of Federal Procurement Policy (OFPP).

The President has requested $1,660,000 for OFPP in FY 1987. This is an increase of $49,000 from the enacted FY 1986 appropriation. The increase is primarily for increases in office space costs and salaries due to routine promotions and within-grade actions.

Reforming the Federal procurement process continues to be an important initiative of this Administration. In 1981, following a Congressional mandate, we submitted a comprehensive proposal to Congress for a uniform Federal procurement system. In 1982, the President issued Executive Order 12352, the first such order to focus solely on the reform of Federal procurement processes. Many of the features of the uniform Federal procurement system proposal and of the Executive Order have now been embodied in the Competition in Contracting Act of 1984 and other recently-enacted statutes. Much more remains to be done, however.

During FY 1987, OFPP will continue to press for government-wide adoption of the remaining reform initiatives contained in the procurement system proposal and in President Reagan's Executive Order. Procurement reform has been fully integrated in our Management and Productivity Improvement Programs. As part of the Productivity Program, Senator Roth has recently introduced two important procurement bills -- S. 2007 and S. 2008. The first of these would revise OFPP's current authority to permit easier testing of various procurement innovations under controlled conditions. Results of the tests would be provided to Congress in the form of further legislative proposals and recommendations. S. 2008 would authorize the implementation of the simplified competitive acquisition technique (SCAT). The impetus for many sole source contracts is lack of time, and SCAT would deal with this by reducing some procurement lead times from an average of 224 days to 75-100 days. Both S. 2007 and S. 2008 have considerable promise for further improving government procurement, and we urge you and your colleagues to give them your careful consideration.

In addition to our legislative initiatives, we are committed to ensuring that the degree of competition in procurement be increased; that the procurement process be further simplified and streamlined; that the Federal procurement workforce be better trained; and, that procurement regulations be further reduced in number and complexity. Procurement reform is an important effort, and I will be looking to OFPP as the principal instrument for achieving that reform.

Mr. Chairman and Members of the Subcommittee: that completes my prepared statement. I shall be happy to address any questions you might have.

ATTACHMENT A: SUMMARY OF VACANCIES AS OF APRIL 7, 1986

SUMMARY OF VACANCIES

1. POSITION: Secretary
Labor, Welfare, Personnel Branch,
Legislative Reference Division

Vacant Since: 12/85

Duties: Serves as the lead secretary and administrative assistant in the branch.

o performs customary secretarial duties.

The backup secretary in this branch has been on maternity leave since January. An employee from the Legislative Information Center in LRD has been detailed to this position.

2. POSITION: Secretary
Economics, Science, General Government Branch,
Legislative Reference Division

Vacant Since: 10/85

Duties: Performs customary secretarial duties in the branch.

The lead branch secretary has been providing all secretarial support in this branch of 5 professionals.

3. POSITION: Attorney
Office of the General Counsel

Vacant Since: 5/85

Duties: The incumbent of this position served as a special assistant to the General Counsel and was responsible for the most sensitive, political issues (tort reform, Superfund, indemnification, insurance system).

These responsibilities have been temporarily assigned to another attorney.

4. POSITION: Attorney
Office of the General Counsel

Vacant Since: 11/85

Duties: The incumbent of this position served as the senior attorney in the Counsel's Office and is responsible for all major projects assigned to the Office. This position has primarily been involved with regulatory review of Medicaid, Medicare, and the other social service programs of HHS and HUD.

These responsiblities have been temporarily assigned to another attorney.

5. POSITION: Attorney
Office of the General Counsel

Vacant Since: 3/86

Duties: The incumbent serves as a general attorney with responsibility for providing legal guidance on all management issues, OFPP programs, Freedom of Information and Privacy Acts, and internal personnel program matters.

These responsibilities have been temporarily assigned to another attorney.

6. **POSITION:** Program Analyst
Office of the General Counsel

Vacant Since: 3/86

Duties: This position is primarily concerned with providing guidance on Federal civil rights issues. The incumbent is responsible for reviewing OIRA rules with civil rights and minority group impact (i.e., SBA rules on disadvantaged persons).

These responsibilities have been temporarily assigned to an attorney in the Office of the General Counsel.

7. **POSITION:** Secretary
Office of the General Counsel

Vacant Since: 3/85

Duties: Performs customary secretarial duties.

These duties are being performed by another secretary in the Office of the General Counsel.

8. **POSITION:** Deputy Chief, Budget Preparation Branch,
Budget Review Division

Vacant Since: 10/85

Duties: This SES level position is responsible for supervising the following activities:

- o organizing the preparation of the budget documents, amendments and supplementals;
- o maintaining liaison with House and Senate appropriations committees on budget matters;
- o coordinating scheduling and clearances of budget materials with agencies, OMB, and White House staff;
- o projecting annual budget outlays from monthly Treasury data; reporting of recission proposals and deferrals under the Impoundment Control Act;
- o reviewing apportionment actions taken under the Antideficiency Act.

A branch employee was detailed to this position to provide coverage for the duration of budget season which created a void in the available staff to perform the normal duties of the branch.

9. **POSITION:** Budget Information Management Specialist (2 vacancies)
Central Budget Management Branch,
Budget Review Division

Vacant Since: 1. 8/85
2. 12/85

Duties: The incumbents of these positions are responsible for:

- o compiling technical material, budget data and related information used to prepare the President's budget;
- o tracking and analyzing congressional action on the budget;
- o analysis of budget alternatives, Gramm-Rudman-Hollings implication, budget resolutions and budget scorekeeping.

These assignments are currently being performed by other branch employees.

10. **POSITION:** Budget Methods Specialist (2 vacancies)
Resources System Branch,
Budget Review Division

Vacant Since: 1. 3/85
2. 3/86

DUTIES:

- o develop and interpret budget methods and procedures for government-wide budget formulation and execution;
- o prepare written materials and instructions on the budget process;
- o review and evaluate budgetary aspects of legislative and management proposals.

These duties have been assigned to other branch employees.

11. **POSITION:** Chief, Resources Systems Branch,
Budget Review Division

Vacant Since: 2/86

DUTIES: This SES level position is responsible for supervising the following activities:

- o formulation and presentation of the President's budget;
- o government-wide employment control;
- o budget related legislative clearance;
- o budget systems operations, concepts and structure.

A senior branch employee has been detailed to this position.

12. **POSIT. /:** Economist
Fiscal Analysis Branch,
Budget Review Division

Vacant Since: 4/85

Duties: The incumbent of this position is responsible for the following:

- o analyze the relationships between the economy and the budget;
- o economic analysis of budget aggregates and sensitivity of aggregates to changes in economic conditions;
- o develop and maintain an economic model to produce the Administration's economic assumptions;
- o analyze state and local finance issues and prepare the Special Analysis on Federal Aid to State and Local Governments.

These duties have been temporarily assigned to another branch employee.

13. **POSITION:** Budget Preparation Specialist (3 vacancies)
Budget Preparation Branch,
Budget Review Division

Vacant Since: 1. 10/85
2. 2/86
3. 4/86

Duties: These positions are responsible for:

- o monitoring and analyzing congressional action on appropriation bills;
- o compiling and analyzing revised budget estimates of government agencies;
- o revising Federal credit data collection activities for the budget;
- o compiling and anayzing agency estimates of spending for the current fiscal year;
- o reviewing agency budget submissions for technical/conceptual accuracy.

These duties have been temporarily assigned to other branch employees. In addition, 2 senior specialists in the branch have announced their departure from OMB in June, 1986.

14. **POSIT..N:** Economist
Office of Economic Policy

Vacant Since: 2/86

Duties: This position is a senior level economist responsible for:

- o economic and legal analysis of tax reform proposals.

These duties have been assigned to another economist although this individual does not have an indepth knowledge of tax reform.

15. **POSITION:** Secretary (2 vacancies)
National Security Division

Vacant Since: 1. 9/85
2. 10/85

Duties: Perform routine secretarial duties in the Air Force and the Army Branches. Both branches currently have 1 secretary responsible for providing support to 4-5 professional employees each.

These duties are temporarily being performed by other division employees.

16. POSITION: Budget Examiner (3 vacancies)
National Security Division

Vacant Since: 1. 9/85
2. 2 new slots

Duties: The incumbents of these positions serve as entry level budget examiners for Intelligence and Military Personnel accounts and are responsible for:

- o review and analysis of agency budget submissions;
- o clearance of legislative proposals and executive orders;
- o analysis of public policy options for assigned programs.

These duties are temporarily being performed by other division employees.

17. POSITION: Chief, State USIA-Branch
International Affairs Division

Vacant Since: 4/86

Duties: This SES level position is responsible for supervising the following activities:

- o formulation and administration of the budgets for the Department of State and the USIA;
- o formulation of fiscal and budgetary policy and application of such policy for Department of State and USIA;
- o clearance of legislative proposals and executive orders effecting the Department of State and USIA.

A branch employee is detailed to this position.

18. POSITION: Budget Examiner
State-USIA Branch,
International Affairs Division

Vacant Since: 2/86

Duties: This senior budget examiner position is responsible for the formulation and execution of the budget of the State Department. This includes:

- o providing advice on planning the OMB work program for the State Department;
- o providing guidance on budget procedures and analysis of State Department budget submissions;
- o assisting in the development of Administration positions on bills and amendments effecting the State Department;
- o providing advice on State Department implementation of major management policies and initiatives.

The branch chief and another senior examiner have shared responsiblity for performing these duties. However, both the branch chief and the senior examiner have recently left OMB.

19. POSITI : Budget Examiner
State - USIA Branch,
International Affairs Division

Vacant Since: 3/86

Duties: This senior level budget examiner position is responsible for the formulation and execution of budgets for international information, exchange and cultural activities of the U.S. Information Agency and the Board for International Broadcasting. This includes:

- o providing advice on planning the OMB work program for assigned agencies;
- o providing guidance on budget procedures and analysis of budget submissions;
- o assisting in the development of Administration positions on bills and amendments effecting assigned agencies;
- o providing advice on implementation of major management policies and initiatives in assigned agencies.

These duties are currently being performed by other branch employees (both of whom are junior level examiners who have worked in the branch less than 1 year).

20. POSITION: Chief, Economic Affairs Branch,
International Affairs Division

Vacant Since: 3/86

Duties: The incumbent of this SES level position is responsible for supervising the following activities for international development and humanitarian assistance programs and non-agricultural export finance programs:

- o formulation and administration of the budget;
- o formulation of fiscal and budgetary policy and the application of such policy;
- o clearance of legislative proposals and development of executive orders;
- o preparation of analyses on a wide range of international trade and finance policy issues;
- o improvement in the organization and management of the agencies responsible for these programs.

A senior level budget examiner in the branch has been temporarily detailed to this

21. POSITIO Secretary
State-USIA Branch,
International Affairs Division

Vacant Since: 5/84

Duties: Perform routine secretarial duties.

Another branch employee has been performing these duties.

22. POSITION: Budget Examiner
Economic Affairs Branch,
International Affairs Division

Vacant Since: 9/85

Duties: The incumbent serves as a junior level budget examiner responsible for:

- o analysis, evaluation and development of options and recommendations on key legislative, policy, budget and management issues relating to international economic affairs issues.

These duties are currently being performed by another branch employee.

23. POSITION: Associate Director for National Security and International Affairs

Vacant Since: 2/86

Duties: This noncareer SES level position is responsible for the overall management of all policy and program analysis and budget examining for national security and international affairs agencies (i.e., DOD, Department of State, USIA, AID, CIA, etc.)

These responsibilities are temporarily being performed by a career OMB manager.

24. POSITI .: Budget Examiner
Housing Branch,
Housing, Treasury and Personnel Division

Vacant Since: 2/86

Duties: This position is a senior level budget examiner responsible for:

- o serving as the lead budget examiner for FHA, Housing Finance and Public Housing Programs at HUD;
- o monitoring and analyzing legislative proposals and testimony supporting these programs;
- o evaluation of administration and regulatory procedures for implementing these programs;
- o review and preparation of formal budget submissions, amendments, supplementals and other necessary budget documents;
- o initiating and monitoring analytic policy work on these program issues.

These duties have been temporarily assigned to other branch employees.

25. POSITION: Budget Examiner
Housing Branch,
Housing, Treasury and Personnel Division

Vacant Since: 9/85

Duties: This junior level budget examiner is responsible for:

- o serving as the budget examiner for housing credit and an assistant examiner for public housing programs;
- o monitoring and analyzing legislative proposals and testimony supporting these programs;
- o evaluation of administration and regulatory procedures for implementing these programs;
- o review and preparation of formal budget submissions, amendments, supplementals and other necessary budget documents;
- o initiating and monitoring analytic policy work on these program issues.

These duties have been temporarily assigned to other branch employees.

26. POSITION: Budget Examiner
Treasury/Personnel Branch,
Housing, Treasury and Personnel Division

Vacant Since: 11/85

Duties: This position is a senior level budget examiner responsible for the following:

- o serves as the senior budget examiner for Postal privatization, Treasury financial issues and Treasury tax expenditures;
- o has specific examining responsibility for reviewing and examing credit, tax and other major finance programs of the Treasury Department including the Federal Financing Bank, the Bureau of Public Debt, the Office of the Secretary and the Office of Tax Analysis.

These duties have been assigned to another branch employee.

27. POSITION: Budget Examiner
Treasury/Personnel Branch,
Housing, Treasury and Personnel Division

Vacant Since: 3/86

Duties: This position is a junior level budget examiner responsible for the following:

- o review and analysis of Treasury law enforcement activities (e.g., Secret Service); OPM and Department of Treasury administrative accounts; and miscellaneous small agencies.
- o monitor and analyze legislative proposals and testimony supporting these programs;
- o evaluation of administration and regulatory procedures for implementing these programs;
- o review and preparation of formal budget submissions, amendments, supplementals and other necessary budget documents;
- o initiate and monitor analytic policy work on these program issues.

These duties have been temporarily assigned to another branch employee.

28. POSITON: Secretary (2 vacancies)
Housing, Treasury and Personnel Division

Vacant Since: 1. 11/85
2. 4/86

Duties: Perform customary secretarial and support duties.

These duties have been temporarily assigned to other division employees.

29. POSITION: Budget Examiner (2 vacancies)
Commerce/Justice Branch,
Transporation, Commerce and Justice Division

Vacant Since: 9/85

Duties: This is a senior level budget examiner responsible for:

- o reviewing and examining criminal justice programs in the Justice Department, including justice assistance grants, crime statistics, and victims compensation;
- o all policy and budgetary issues associated with the Merit Systems Protection Board.

These duties have been assigned to another branch employee.

30. POSITION: Budget Examiner
Transporation, Commerce and Justice Division

Vacant Since: 3/86

Duties: The incumbent of this position serves as a special staff assistant to the division chief. As such, the employee is responsible for:

- o coordinating all administrative functions for the division (budget, personnel);
- o on the basis of division priorities and relative workload, the incumbent is assigned budget examining responsibilities in transportation, commerce, or justice programs.

These duties are being carried out temporarily by the division chief and the previous incumbent of the position (who was reassigned to another budget examiner position in TCJ) on a part-time basis.

31. POSITION: Economist
Economics and Government
Special Studies Division

Vacant Since: 3/86

Duties: The incumbent is responsible for:

- o designing and completing economic analyses;
- o developing and completing major policy analyses for programs in: Departments of Treasury, Justice, Commerce, Transportation, and HUD; GSA, OPM and most independent financial, commercial and other regulatory agencies (i.e., SBA FHLBB, FDIC).

These duties are currently being performed by another division employee.

32. POSITION: Deputy Associate Director
Economics and Government
Special Studies Division

Vacant Since: 12/85

Duties: This SES level position is responsible for the following:

- o managing the conduct of special analyses of public policy issues with the Departments of Treasury, Justice, Transporation, Commerce, and HUD; GSA, OPM, and most independent financial, commercial, and other regulatory agencies (i.e., FDIC, FHLBB, SBA).

These supervisory responsibilities are being shared by two senior analysts in the division.

33. POSITION: Research Assistant
Economics and Government
Special Studies Division

Vacant Since: new position

Duties: Perform routine duties in entering and maintaining data on a personal computer file.

These duties are currently being performed by the professional staff in the division.

34. POSITION: Secretary
Health and Income Maintenance Division

Vacant Since: 10/85

Duties: The incumbent of this position serves as the lead secretary in the division and supervises the word processing function in HIMD.

Another branch secretary has been temporarily assigned these duties.

35. **POSITION:** Chief, Income Maintenance Branch,
Health and Income Maintenance Division

Vacant Since: 9/85

Duties: The incumbent of this SES level position is responsible for supervising the following activities:

- o formulation and administration of the budget for all income maintenance programs (social security, food stamps, aid to families with dependent children, etc.);
- o legislative, economic, management and organizational analyses on income maintenance programs.

A current branch employee has been assigned these responsibilities.

36. **POSITION:** Budget Examiner (six vacancies)
Health and Income Maintenance Division

Vacant Since: 1. 4 positions, 9/85
2. 2/86
3. 3/86

Duties: The incumbents of these positions serve as senior level budget examiners in the following areas:

- o review and analysis of agency budget submissions in health policy and health financing programs (Medicaid, Medicare, Public Health Service);
- o review and analysis of legislative, regulatory and organizational issues effecting these programs.

Other division employees have been assigned these duties.

37. **POSITION:** Budget Examiner
Veterans Branch,
Labor, Veterans and Education Division

Vacant Since: 3/86

Duties: This senior level budget examiner is responsible for the analysis and review of programs in the Veterans Administration including education, housing, health and income maintenance. This includes:

- o monitoring and analyzing legislative proposals and testimony;
- o evaluation of administration and regulatory procedures;
- o review and preparation of budget submissions, amendments, supplementals and other documents;
- o initiating and monitoring analytic policy issues.

These duties have been assigned to another branch employee.

38. **POSITION:** Economist (2 vacancies)
Human Resources, Veterans and Labor
Special Studies Division

Vacant Since: 1. 8/85
2. 8/85

Duties: Conduct cross-cutting and indepth analyes of human resources policy issues. The incumbents are assigned responsibilities for long and short term analytic studies in HRVL policy issues.

These duties have been assigned to other staff members in the division.

39. **POSITIC** Budget Examiner
Nuclear Energy Branch,
Energy and Science Division

Vacant Since: new position

Duties: The incumbent serves as an entry level budget examiner responsible for:

- o analysis, evaluation and development of options and recommendations on key legislative, policy, budget and management issues relating to nuclear energy programs.

These duties are currently being performed by other branch employees.

40. **POSITION:** Deputy Chief, Energy and Science Division

Vacant Since: 3/86

Duties: This SES level position is responsible for assisting with the management of the Energy and Science Division. This includes responsibility for the following duties concerning nuclear and non-nuclear energy programs, and science and space programs:

- o analysis, evaluation, and development of options and recommendations on key legislative, policy, budget and management issues.

Another division employee has been temporarily detailed to this position.

41. **POSITION:** Budget Examiner
Interior Branch,
Natural Resources Division

Vacant Since: 12/84

Duties: Serves as the budget examiner for all social services programs coordinated by the Bureau of Indian Affairs including responsibility for the following:

- o review and analysis of budget submissions;
- o review and analysis of proposals effecting assigned BIA programs (legislative, regulations, and management).

These duties have been assigned to another branch employee.

42. **POSITION:** Secretary
Agriculture Branch,
Natural Resources Division

Vacant Since: 10/85

Duties: Performs customary secretarial duties as the backup secretary in a branch with 9 professionals.

These duties have been assigned to another branch secretary.

43. **POSITION:** Chief, Water Resources Branch,
Natural Resources Division

Vacant Since: 8/85

Duties: The incumbent of this SES level position serves as the main OMB contact for all budgetary issues on water resources programs (particularly those of the Army Corps of Engineers and the Bureau of Reclamation). This includes supervising the following activities:

- o formulation and administration of the budget for water resources programs;
- o legislation, economic, management and organizational analysis on water resources programs.

A branch employee has been detailed to this position, with other branch employees carrying the workload for this detailed employee.

44. **POSITION:** Management Analyst (2 vacancies)
Financial Management Division

Vacant Since: 1. 12/84
2. 4/85

Duties: The incumbents of these positions are responsible for the review and analysis of issues associated with:

- o credit management and debt collection practices throughout the Federal government;
- o development and planning of streamlined accounting systems in Federal agencies.

These duties have been assigned to other division employees.

45. **POSITION:** Secretary
Planning and Communications Management Division

Vacant Since: 8/85

Duties: Perform customary secretary duties

This responsibility is being performed by other division secretaries.

46. POSITION: Management Analyst
Planning and Communications Management Division

Vacant Since: 6/84

Duties: This senior level analyst is responsible for overseeing management liaison activities to include:

o coordination of management initiatives with agency staffs and OMB program divisions.

These responsibilities have been assigned to other division employees.

47. POSITION: Secretary
Management Improvement Division

Vacant Since: 7/85

Duties: Perform routine secretary duties.

These duties are being performed by other division employees.

48. POSITION: Assistant to the Associate Director
Management Improvement Division

Vacant Since: 2/86

Duties: This SES level position is responsible for managing and supervising the following OMB management functions:

o special projects on management reform and management improvements;

o coordination with Cabinet Councils on various management improvement projects.

These duties are currently being performed by other division employees.

49. POSITION: Secretary (2 vacancies)
Office of Information and Regulatory Affairs

Vacant Since: 1. 6/85
2. 8/85

Duties: Responsible for performing routine secretarial duties.

These responsibilities have been assigned to other OIRA employees.

50. POSITION: Secretary
Office of Information and Regulatory Affairs

Vacant Since: 3/86

Duties: The incumbent of this position serves as the lead secretary in the Statistical Policy Branch and is responsible for performing customary secretarial duties.

These duties have been temporarily performed by the backup secretary in the branch.

51. POSITION: Policy Analyst
Reports Management Branch,
Office of Information and Regulatory Affairs

Vacant Since: 6/85

Duties: The incumbent of this position serves as the VA desk officer and is responsible for:

o implementing reform initiatives to reduce costs, paperwork and other burdens;

o providing regulatory policy guidance and analysis for VA issues;

o reviewing regulations, paperwork and information management activities for the VA.

These duties have been temporarily assigned to other branch employees.

52. **POSITION:** Economist
Regulatory Analysis Branch,
Office of Information and Regulatory Affairs

Vacant Since: new position

Duties: The incumbent of this position is responsible for economic issues with respect to regulatory impact analysis in the following areas:

- o revising regulations and policies issued by Federal health and safety agencies;
- o performing cost benefit, cost effectiveness and risk analyses of regulatory proposals.

The duties have been temporarily assigned to other branch employees.

53. **POSITION:** Budget Officer
Administration Office

Vacant Since: 8/85

Duties: The incumbent of this position serves as the OMB Budget Officer and is responsible for:

- o formulation of the budget submission for OMB;
- o monitoring the execution of the budget;
- o review of financial management data for OMB.

These duties have been assigned to another Administration Office employee, with the Office Chief (the previous incumbent of this position) providing day-to-day assistance.

54. **POSITION:** Confidential Secretary
Office of Legislative Affairs

Vacant Since: 2/86

Duties: Perform routine secretarial and support responsibilities.

These responsibilities are temporarily being performed by another OMB employee detailed to this office.

BUDGET REQUEST

Mr. MILLER. OMB's budget request for fiscal year 1987 is $39,682,000—in nominal terms about 11 percent above our appropriation for fiscal year 1986, after the Gramm-Rudman-Hollings sequester. However, the request—again in nominal terms—is only 2 percent above our operating level for fiscal year 1985. In fact, it is less in real terms than for 1985.

I believe our request for fiscal year 1987 represents a prudent level of funding which will enable us to continue providing the President with the necessary support to participate effectively in an increasingly complex budget process and to carry out his numerous management and regulatory initiatives.

About 86 percent of OMB's budget is for personnel compensation and benefits, standard level user charges, printing of the President's budget and related documents, and text and data processing support.

An additional 3 percent is for telephone service, postage, utilities, and rental of equipment. The remainder covers staff travel and training, background investigations, ADP and other equipment purchases, and office supplies.

Mr. Chairman, as you know, in recent years OMB has been appropriated less than the President had requested. In real terms, OMB's fiscal year 1986 budget authority, after the sequester, is approximately 14 percent below the level appropriated for fiscal year 1981. Over two-thirds of this reduction occurred in fiscal year 1986 because of the sequester, but also because in real terms the appropriation for fiscal year 1986 was actually below the appropriation for fiscal year 1985.

We have absorbed these reductions in two ways. In the long run, we have made wise investments in productivity-enhancing automated data processing systems, and implemented a variety of cost saving measures such as limiting optional travel—I am doing a lot less travel at OMB than I did at the Federal Trade Commission, partly because the workloads are heavier. In addition, we have reduced the amount of space occupied by OMB staff and have used new technology to reduce printing costs. These improvements in overall efficiency have allowed OMB to continue performing its mission while using fewer resources.

In the short run, we have taken a number of cost saving steps, the most important of which is that we have imposed a near freeze on new hiring. Currently, I understand over 60 of our 594 positions, or 10 percent, are vacant. The positions include the Associate Director for National Security and International Affairs, and Chief of our Water Resources Branch, and Deputy Chief of our Budget Preparation Branch.

Senator ABDNOR. That is one thing. We did not give you the money. Those are the positions you would have filled had you had the money?

Mr. MILLER. Let me just say, of course, I am going to fill the Associate Director of the National Security and International Affairs, the Chief of the Water Resources Branch, and the Deputy Chief of our Budget Preparation Branch.

But these are just a few of the positions now vacant. Again, the reason we have not filled them is so we can meet OMB's budget, consequently, we are imposing a virtual freeze on new hires.

In addition, we have reduced our budget for equipment purchases and put off plans for replacing our faltering word processing system; limited our budget for cash awards for employees; and reduced the amount we have budgeted for overtime.

These cutbacks, I should add, have been imposed in the face of a significantly increased overall workload. We expect that nearly 40,000 work hours will be expended during fiscal year 1986 in implementing the new processes mandated by Gramm-Rudman-Hollings, and about 15,000 hours in fiscal year 1987. Gramm-Rudman-Hollings has also increased our printing costs significantly and will continue to do so in the future.

We estimate Gramm-Rudman-Hollings costs about $500,000 a year in additional costs.

Senator ABDNOR. A one-time deal?

Mr. MILLER. No, no; it was greater in 1986 than in 1987. But it is over $500,000 in 1986 and slightly less in 1987. It depends, of course, greatly on what happens. If there is a sequester, the costs will be a lot higher.

Congress and the administration have embarked together on a path to eliminate the deficit by 1991. Meeting this goal will require careful analysis and extensive coordination. We must eliminate those Government programs that are not justified, pare those that are bloated, preserve those that are warranted, and increase those that are of highest priority. And we must continue to implement management and regulatory reforms to ensure Government uses the minimum resources necessary to serve our citizens and does this in a way that poses the least threat to their well-being.

Mr. Chairman, that completes my statement. I would be glad to respond to any questions you have.

Senator ABDNOR. Fine.

Senator Mattingly?

Senator MATTINGLY. Thank you.

You mentioned that $500,000 would be required to implement Gramm-Rudman. To do what?

Mr. MILLER. We have to prepare the report to Congress on what we estimate the deficit to be. We were doing this last year while at the same time we were trying to produce the budget. Then we had to produce, together with the Congressional Budget Office [CBO], documents detailing the amount of the sequester.

Senator MATTINGLY. What would happen if you did not have to comply with Gramm-Rudman?

Mr. MILLER. What we did was absorb the additional costs out of our traditional budget resources. It means some of those things were not done.

It means also the people, especially in the Budget Review Division, were working long hours without any compensation. It is the kind of thing you can do once in awhile, but it really hurts morale. After awhile, the dog ain't friendly any more.

CONSULTANTS

What we have experienced, under Gramm-Rudman-Hollings, is a 4.3-percent reduction for civilian accounts. This applies to personnel accounts across the board.

Gramm-Rudman-Hollings has a provision in it that says all cuts should be made in a fashion that would cause minimal inconvenience to employees.

Our bureaucratic behavior is to expand. It is a lot easier for managers to use consultants rather than to use in-house employees. As a result, there may be a bit of attrition there.

Senator MATTINGLY. Sometime ago an Executive order was drafted that was supposed to try to control expenditures for Federal consultant costs, and it has never been implemented.

What is the status of that order?

Mr. MILLER. Let me just mention to you I made a presentation to the Cabinet and the President about 1 month ago where we talked about management issues. The issue of consultants was raised.

I understand your provision would be a 10-percent cut across the board for every agency, or is it 10 percent in the aggregate?

Senator MATTINGLY. We have tried to reduce such costs by 10 percent.

We have worked with Secretary Weinberger and his staff in an effort to reduce consultant expenses in the Department of Defense [DOD].

Mr. MILLER. I have been told that DOD is not restrained by the provision.

Senator MATTINGLY. That is correct.

We reduced the amounts available for consultants in the DOD authorization and appropriations bills.

Mr. MILLER. Let me say again I think that the basic proposition that the Government tends to overuse consultants is correct, and placing some limitation on their use makes sense.

Let me get the details and get back to you.

Senator MATTINGLY. Also give an assessment of what savings accrued in that time.

[The information follows:]

You asked for estimates of savings achieved through efforts to reduce consulting services as well as information on actions taken in this area. In two of the efforts mentioned below, information on savings related to consulting services is available. Specifically, data on savings achieved or proposed for rescission for 1985 associated with section 2901 of the Deficit Reduction Act of 1984 were provided in the President's management report for the 1986 budget. For the section 515 effort for 1986, data are available from agency justifications transmitted directly to the Congress. In these and other reductions described below, the data were not collected centrally by OMB.

Let me also summarize our efforts in the last 2 years.

In response to section 8112 of the Defense Appropriations Act of 1985 and section 308 of the Defense Authorization Act of 1985, the Department of Defense took a number of actions to limit, control, and improve the management of consulting and related services. These actions included limiting spending on certain consulting services to $1.3 billion in 1985 and issuing and implementing new instructions for managing and controlling these services. Details on these efforts are provided in a report forwarded to the Congress in February 1986.

In addition, section 2901 of the Deficit Reduction Act of 1984 required large reductions in 1985 for consulting services and section 515 of the Treasury, Postal Service and General Government Appropriations Act of 1985 required a 10-percent reduction in that year. Section 2901 required that the Director of OMB report on the savings achieved or proposed for rescission. This was done in the President's management report transmitted with the 1986 budget.

Subsequently in 1986, nondefense agencies with budget requests for 1986 of $5 million or more for consulting services placed 10 percent of such amounts in reserve. Section 515 did not provide a role for the Director of OMB in this effort. Nevertheless, OMB issued instructions asking agencies to deduct the amounts reserved from budgetary resources available for obligation and report savings achieved from this effort in 1986 directly to the Congress. Specifically, they were directed to report the amount of the reduction along with the consulting service information that they are required to submit in individual agency budget justifications to the Congress pursuant to 31 United States Code 1114.

Moreover, the Balanced Budget and Emergency Deficit Control Act of 1985 (known as Gramm-Rudman-Hollings) required a 4.3-percent reduction in civilian agencies in 1986 from the same pool from which consulting services are financed. For defense programs, the Gramm-Rudman-Hollings reduction was 4.9 percent in 1986. For both civilian and defense programs, Gramm-Rudman-Hollings, may also result in a 1987 sequestration affecting the same pool.

In view of the many reductions taken in the past, the possibility of a Gramm-Rudman-Hollings reduction in 1987, and the model control systems instituted at the Defense Department and other agencies, no general provisions constraining the use of consulting services were proposed in the 1987 budget. In the near future, we will be issuing a revised OMB Circular No. A-120 to clarify guidance to the agencies in this area.

OIL PRICES

Senator MATTINGLY. On another matter, we have received a response from DOD in reply to my inquiry about what effect the decline in oil prices would have on the budget.

Mr. MILLER. Two billion?

Senator MATTINGLY. It depends on how far it drops. For example, savings are estimated at $0.8 billion at $20 a barrel; $1.8 billion at $15 a barrel; and $2.8 billion at $10 per barrel.

That is in defense. We have not pursued this, but how about the balance of the Government, what impact——

Mr. MILLER. Yes; the major savings are in DOD. There will be some other savings from such items as motor vehicles. But, the effect on the budget itself goes both ways because it cuts oil revenue from offshore and windfall profit tax.

I am not being critical of lower prices by saying that, but the effects on the budget are mixed. The effect of the lower oil prices have a salutary effect on economic growth as well.

Senator MATTINGLY. But no economist in the world can say it is zero impact.

Mr. MILLER. No; but I was going to say it lowers the rate of inflation. So there may be less revenue as well. But, in terms of the deficit, it is a plus.

[The information follows:]

MEMO FROM JAMES C. MILLER, III

APRIL 15, 1986.

Hon. MACK MATTINGLY,
U.S. Senate, Washington, DC.

DEAR MACK: Thank you for your letter regarding budget savings resulting from oil price reductions.

The prices of fuel products included in the 1987 President's budget assume an average crude oil price of $24.08 per barrel. Each dollar decrease in the price per barrel of crude oil should eventually result in a dollar decrease in the per barrel price of the fuel products purchased by the Government.

The 1987 defense budget includes funds for the purchase of 193 million barrels of fuel. At $20 per barrel for crude oil DOD would save $0.8 billion, at $15 per barrel the savings would be $1.8 billion and at $10 per barrel the savings would be $2.8 billion. I understand the Department of Defense will be providing you with additional information on how fuel price reductions might be reflected in the defense budget.

Direct fuel price savings in the rest of Government are substantially smaller—about $50 million at $20 per barrel, $120 million at $15 per barrel, and $200 million at $10 per barrel.

Considerably outweighing the direct budget savings from lower oil prices are likely losses of receipts from the windfall profit tax, offshore oil lease sales, and sales of petroleum from the naval petroleum reserves. While the offshore leasing receipts are particularly difficult to estimate, the combined loss of petroleum-related receipts at a crude oil price of $15 per barrel might be three times the combined defense and civilian agency savings on petroleum and petroleum product purchases. The net result of these direct effects—at $15 per barrel—is roughly a $4 billion increase in the 1987 deficit.

You should note that these are the direct effects only, and do not incorporate secondary effects on the Consumer Price Index, enconomic growth, and so on.

Please let me know whenever we may be of assistance.

Sincerely yours,

JAMES C. MILLER, III,
Director.

SPENDING LEVELS—1981-86

Senator MATTINGLY. There is nothing bad that can be said about this man, Mr. Chairman.

Senator ABDNOR. Oh, I am glad you told me. [Laughter.]

Are you through?

Senator MATTINGLY. Yes.

Senator ABDNOR. Would you mind quoting and give us for the record 1981 through 1986 and the numbers?

Mr. MILLER. In 1981, the nominal budget authority for the OMB, not counting OFPP, was $33.5 million. It was $33.5 million in 1982; $35 million in 1983; $37.3 million in 1984; $38.9 million in 1985; $37.3 million prior to the Gramm-Rudman-Hollings sequester; and $35.7 million postGramm-Rudman-Hollings sequester.

Senator ABDNOR. How much was that——

Mr. MILLER. Gramm-Rudman-Hollings cut us down to $35.7 million. From $37.3 million to $35.7 million.

For 1987, we are requesting $39.7 million which, I understand, is actually less in real terms than was appropriated in 1985.

Senator ABDNOR. You had about as many more people working in 1981 probably as you do in——

Mr. MILLER. Yes; yes, sir.

We actually had 580 full-time people on the board at the end of fiscal year 1981. Our 1987 request will provide for approximately 542 positions for 1987.

Senator ABDNOR. I am over here on page 1. About 86 percent of OMB's budget is personnel.

Mr. MILLER. Eighty-six percent of OMB's budget is for personnel compensation and benefits, standard level user charges, printing of the President's budget, and text and data processing support.

Senator ABDNOR. Also, maybe for the record—we have asked this question of all the witnesses—of OMB, how have you implemented the Gramm-Rudman-Hollings reductions? And if you can provide a detailed accounting, we would kind of like that.

Mr. MILLER. Sure.

[The information follows:]

OMB's 1986 operating level is $3.7 million below the President's revised 1986 request. $1.6 million of this cut is attributable to Gramm-Rudman-Hollings. In order to accommodate this reduction, we have cut back on travel, training, supplies, ADP support, and implemented a near freeze on all new hires. Since OMB is labor intensive, the only way to accommodate reductions of this size is through reduced staffing. Currently, OMB has over 60 positions vacant.

STAFFING

Mr. MILLER. Since we are very labor intensive, the way we have met it is to not hire people and let attrition take its course.

Senator ABDNOR. How many bodies does that include, do you know offhand?

Mr. MILLER. Jeff.

Mr. EISENACH. We are down about 68 position from our authorized level. In terms of where we would be operating, at this point, about 40 positions from where we otherwise would be.

Senator ABDNOR. That is probably where most of these reductions come. Gramm-Rudman-Hollings must have taken some of it?

Mr. MILLER. I think he is saying 26——

Mr. EISENACH. Attributed to Gramm-Rudman-Hollings? That would be in the neighborhood of 26.

Senator ABDNOR. OMB is seeking a 1-percent increase. It seems a very little increase.

I had the Federal Elections Commission in here yesterday. If I cut them any more, they are going to fold up, in all honesty. There are a number of other agencies. Some of us felt law enforcement, particularly Customs, had to be reduced. This budget we are working on is not going to be good. Even the Internal Revenue Service [IRS] is going to get hurt considerably. Probably in that supplemental.

That supplemental is going to be very difficult. Not only what might happen to individuals, but how much we can actually put in, how far we can go. We are a little different from the House.

Mr. MILLER. Yes; I know there is a difference.

Senator ABDNOR. Do you think OMB can justify the larger increase—I guess that is what I am saying—than some of these others?

The budget you are coming in with is a figure you can live with? I am not denying you could probably well use the 11-percent increase. But I am going to get looked right in the eye by a lot of these other agencies so tell me how in the world do you expect us to go on when OMB is getting an 11-percent increase?

Mr. MILLER. As you know, the decrease this year was a rather exceptional one.

Senator ABDNOR. What was it, $3 million?

Mr. MILLER. It is more than that after the sequester.

The point I would make is that because of Gramm-Rudman-Hollings, we had these increased work requirements. At the same time, however, we are coming in at less, in real terms, than OMB's operating level in 1985.

I would just point out—and I do not want to sound too defensive about it—but OMB's path is actually downward in terms of personnel. The two sister agencies, I guess, that would be most relevant for comparison would be the Congressional Budget Office [CBO] and the General Accounting Office [GAO], both of which have increased rather substantially.

Senator ABDNOR. The Senate Budget Committee—I am sure you reviewed their work very closely by now—reported their resolution, and it calls for a freeze on most accounts, including OMB.

Tell us your reaction to that.

Mr. MILLER. For the reasons we have gone over this morning, and for the reasons contained in the materials you have before you, I think the President's mark is justified for OMB.

Senator ABDNOR. Senator DeConcini?

CENTRAL ARIZONA PROJECT

Senator DECONCINI. Thank you, Mr. Chairman.

Director Miller, how are you this morning?

Mr. MILLER. I am fine. How are you, sir?

Senator DECONCINI. Well, fine until yesterday.

In the conversation I had with Secretary Hodel, I was advised that OMB has registered its objections to certain provisions for the sharing plan for plan 6 for the central Arizona project which is scheduled to be signed next Tuesday.

Are you familiar with that at all?

Mr. MILLER. I am not, except that I have a recollection that some questions were raised about whether the cost-sharing provision meets the legal standards.

Senator DECONCINI. Let me tell you, the biggest problem I have is that Hodel states to us that he has kept OMB abreast of the details of this cost-sharing plan all through the negotiations, which has taken about 6 months now.

My purpose here is not to debate the objections OMB had. One of them is from Treasury on the issue of tax-exempt bonds, and another one is OMB's basis of how the construction is scheduled.

What really troubles me is a week before it is signed, OMB zeros in on it. Are you so hard up for people that you could not be looking at this months ago, so we would not be faced with this possible nonsigning next Tuesday?

Mr. MILLER. Again, my recollection is that we had been monitoring it. But I expected that what the parties were willing to sign would have met the cost-sharing standards, as we interpret the law.

Senator DECONCINI. Can I ask you to look at it today or tomorrow, please?

Mr. MILLER. Sure, yes.

Senator DECONCINI. It is very important. I think it is important not only for my State, which is obviously parochial, on my part, but I think it is important because it is a new approach, one that I certainly have turned 180 degrees on, and I just did not believe it was right to get into this cost sharing on an already authorized project.

But we are doing it, and Arizona is making a giant step with $360 million. Even if some of it is financed through tax exempt bonds, it is still an obligation to the State.

I just hope you can take a look at that for us in the next day or two, and maybe help us to resolve it, so we can go ahead with the signing ceremony, and get it behind us.

[The information follows:]

LETTER FROM JAMES C. MILLER, III

APRIL 14, 1986.

Hon. DENNIS DECONCINI,
U.S. Senate, Washington, DC.

DEAR DENNIS: I have looked into the central Arizona project plan 6 cost sharing situation pursuant to our discussion and your letter of yesterday.

We have indeed been discussing the substance of the negotiations with the Bureau of Reclamation at the staff level since last October, and have been raising issues related to Governmentwide policy on water project cost sharing as the negotiations went along. We also reviewed the provisions of the agreement worked out by field negotiators concurrently with the policy review by the Secretary of the Interior, and informed him of issues raised by OMB staff as well as by other agencies, including Justice, Energy, and Treasury.

I am pleased to inform you that the Secretary of the Interior and I have satisfactorily resolved all differences between our respective staffs in regard to the plan 6 agreement, and that all parties are aware of the remaining uncertainty—that the Secretary of the Treasury may not be able, under current law, to certify that local bonds guaranteed by a surcharge on sales of Federal electric power may bear interest exempt from Federal taxation. While this issue does not directly affect the agreement with the Department of the Interior, we believe that it may affect the plans of the non-Federal parties to the agreement.

Please let me know whenever we may be of assistance.

Sincerely yours,

James C. Miller, III,
Director.

CUSTOMS SERVICE

Senator DeConcini. In other areas, Director Miller, despite the role that the U.S. Customs Service has played in our war on drugs and revenue collection efforts, OMB seems to continue to send up budgets to the President and Congress that slash this important agency, to what I believe are unacceptable levels. Fortunately, Congress has restored funding for Customs virtually every year since President Reagan has been in office. We had to do the same thing under President Carter, except for 1 year.

Frankly, I believe OMB does the President a real disservice by sending up budgets for Customs that have no justifications or adequate rationale.

Can you tell us why you continue to do this—cut the very important drug interdiction and revenue agency area? After all, nearly $15 billion a year goes into the Treasury just from Customs' efforts, not to mention what the President has said publicly, that the No. 1 enemy to this country is organized crime and drugs. Yet OMB cuts Customs, which is the first line of defense of air interdiction. It just bewilders me.

Mr. Miller. Senator, by coincidence, the reason I have to get back by 11 o'clock is a meeting with the President on the Drug Law Enforcement Program.

The administration has undertaken a comprehensive review of the role of the whole Federal drug program, and tried within the restraints of a Gramm-Rudman era to allocate resources in the most effective way, in our judgment, to reduce the flow of drugs.

Despite being in a very stringent fiscal environment, the overall Federal Drug Law Enforcement Program is getting $146 million more in fiscal 1987 than in 1986—$146 million more.

It is true that some additional funding provided by the Congress for the Customs Service Air Interdiction Program was cut out, with the reason being that we believed it was not cost effective.

Senator Abdnor. Wait a minute. Do you really believe that?

Mr. Miller. Yes; however, I have not gone out and looked, and flown on the airplanes.

Senator DeConcini. Why do you not do that, Mr. Miller?

What you have done is added money to the investigative agencies, and they may need it. I think in some cases they do.

Mr. Miller. Well, they are getting a lot more convictions.

Senator DeConcini. Yes; particularly in the area of prosecution. But here you have 50 percent of the cocaine coming in by aircraft.

We have really a bipartisan coalition of members, Senator Abdnor and myself, and others on the House side who have put together a thoughtful program, over the objection of Treasury at first, to do something about air interdiction.

The transfer of military equipment which I think you cut—the recission was $27 million—is really a small amount of money for a program that, I think, works. Maybe because I have been out to see how the F-15 radar lash onto planes 100 kilometers and more away.

I just wonder if you people, who are making decisions, have really had a hands on observation of what we are doing. Senator Abdnor has, and I have.

Mr. MILLER. I will go back and get with the folks who are in charge of this area and establish it more to my satisfaction.

[The information follows:]

Senator DeConcini, I can assure you that OMB staff have participated in first-hand observations of the Customs Service Air Interdiction Program throughout the country.

The administration is concerned about the overall cost effectiveness of the Air Interdiction Program within the Customs Service. The appropriate relationship between the investment for air interdiction resources and the optimal strategy for reducing drug abuse in America is unclear.

While the entire national drug law enforcement strategy, including drug interdiction efforts, is being reviewed by the National Drug Enforcement Policy Board, the administration is simply proposing a pause in the previous rapid growth rate of the Customs Service air interdiction budget. The funding levels proposed in 1986 and 1987 are consistent with actual operations in 1985 and will not restrict the Customs Service's ability to detect and intercept drug smugglers.

In criticizing the administration rescission proposal for the Customs Service Air Interdiction Program, you must recognize that the major portion of this reduction involved a $9 million high-altitude radar balloon for the Southwest border. The administration is not convinced that this aerostat is the appropriate response to the drug smuggling effort in that area.

—A tethered aerostate is very inflexible, and cannot be rapidly deployed when and where needed.

—A single tethered aerostat would be ineffective as the smart drug smugglers would easily avoid the radar-covered area.

—It is uncertain whether a tethered aerostat will operate effectively in the mountainous terrain along the Southwest border; aerostat use in those conditions has never before been attempted.

WAR ON DRUGS

Senator DECONCINI. Since last year we have been negotiating with the Pentagon over a way to implement this new plan, and we are close to an agreement on a way to bring the military in on the war on drugs. However, I am informed that the only remaining obstacle is OMB. This is apparently because it will take some resources to fund the new initiative of the military being involved—the Air Reserve wing.

You are holding up final approval of a plan that has the support of the Air Force, the Drug Task Force Office, and Secretary Weinberger's office. And we would like to know what makes your obstruction to the President's own Commission on Organized Crime, that has said that we should have the military more deeply involved.

Mr. MILLER. Yes; there is the problem of posse comitatus. You cannot have military people arresting and detaining civilians. You have to work it out carefully.

Senator DECONCINI. I know.

Mr. Miller, our program was worked through with the Justice Department, and the Defense Department approved it. You know, we altered the Posse Comitatus Act. We understand the military significance. This program does not infringe on that. The President signed it twice, so it is the law of the land.

And yet somebody in your organization was stopping what the President wants to do, what the Congress wants to do. And I just would appreciate it if you would find out for yourself what in the world is going on.

Mr. MILLER. Yes.

Senator DECONCINI. It is just very hard for us not to be very critical. And this is not my purpose today, my purpose is to implore you to please try to get this approved.

Senator ABDNOR. Like a fire department in a town. Maybe it would be cost effective, I do not know. But the lives they save, and the homes they save, the buildings, it is effective.

And here you are dealing with things that are more important than houses and businesses. You are talking about lives.

Obviously, somebody feels something should be done, because they put a lot of additional dollars in this Drug Enforcement Administration and Federal Bureau of Investigation. I am not quarreling with that. I think that is very necessary. But your front line efforts start with the border where you have this stuff coming in. It is a lot harder to root it out. Maybe it is not as colorful as a raid on some drug traders.

Look what we have done down in Florida. We are bragging about it now, all the wonderful things we have done. But now it puts it into history.

Senator DECONCINI. You need to take some time, and I know you are busy. God knows, I do not know how you do all the things you do. But you need to take some time to look at what Customs has, and what they need.

We are not talking about hundreds of millions of dollars, we are talking about a couple P–38's in storage to be refitted with F–15 radar. We are not talking about a new major military operation.

Mr. MILLER. I will look.

[The information follows:]

Section 1422 of the 1986 Department of Defense Authorization Act required the Secretary of Defense to report to the Congress on plans for implementing the air drug wing. An interim report regarding rotary wing aircraft was sent to the Congress on January 31, 1986.

As part of our overall budget and legislative clearance responsibilities, the Office of Management and Budget reviewed a draft report on fixed wing aircraft support that was due to Congress on March 31, 1986. It is our understanding that this report did not have the approval of the Department of Defense.

Because of the significant budget implications on nondefense agencies and programs, the Office of Management and Budget asked the Defense Department to submit the revised report to the National Drug Enforcement Policy Board for review. We believe that review of the defense report by the Policy Board is in keeping with the intent of Congress in creating the Board and expect the review to be completed soon. We all want an effective antidrug program.

GRAMM-RUDMAN-HOLLINGS

Senator DECONCINI. Thank you.

Let me ask you one more question, and then I will submit these.

I have been reviewing the budget for the Treasury agency funding in the Treasury appropriations bill. I noticed that the Internal Revenue Service [IRS], in all but four other accounts, were requesting full restoration to the Gramm-Rudman-Hollings first sequester cut in their 1987 budget.

Now, we called Senator Gramm's office, to see what he thought about that. He was upset. He said that is not the intent of the sequester.

Your budget for 1987 reflects an increase of nearly $4 million over the post-Gramm-Rudman-Hollings sequester level. My question is, are you requesting restoration of all or part of the $1.6 million Gramm-Rudman sequestered in fiscal 1987?

If so, why? And why not start with the lower base, like I think we are supposed to?

Mr. MILLER. Before Gramm-Rudman, we were already considering a supplemental for IRS in 1986. Part of the reason was due to the problems we had last year in processing returns. We did not want that to repeat.

Our sending up a $340 million emergency supplemental for IRS in 1986 is not meant to restore the Gramm-Rudman-Hollings cut, but it was a supplemental that was in process before the Gramm-Rudman-Hollings sequestering.

For 1987, when we put the details of the President's budget together, after he gave us his specific parameters; we did not go back and say let us first restore for the agency what the cut was——

Senator DECONCINI. Well, it looks like it.

Mr. MILLER. We did say that our objective was to reach a $144 billion deficit. Given the President's priorities, how do we spread those funds among the agencies? In some cases it meant more—more acquired immune deficiency syndrome research, more National Aeronautics and Space Administration funding, some more in national defense. In other cases, it meant less.

That is the way we did it, rather than first restoring funds to other programs.

INTERNAL REVENUE SERVICE

Senator DECONCINI. In the IRS case, while they had that request before you, even before it is approved, are you aware that it was hiring people?

[Mr. Miller shaking head.]

Senator DECONCINI. I was very upset. With no deficiency apportionment from OMB, and without the approval of the Congress and the committee, they have hired those people. It puts the chairman and myself in the position where maybe we are really not needed here.

If the administration decides they need 5,000 or 700,000 agents, go ahead and do it, and why come to the Appropriations Committee? And now they have hired them.

Mr. MILLER. We apportion on a deficiency basis only when we think the agency is in an emergency situation.

The administration believed—and still believes—that it was absolutely critical for the IRS to have a smooth filing season this year. The IRS needed to devote substantial resources last fall to eliminating some of the backlogs in the service centers before the filing season began.

It was not until mid-January before we knew what the full resource impact would be of preparing for the 1986 filing season. Once we had agreed on the size of the supplemental, a review process began to determine which amounts, if any, could be apportioned on a deficiency basis.

We have now sent a notice to Congress that $273 million of the $340 million has been apportioned on a deficiency basis. As you know, this enables IRS to spend at a higher rate in anticipation of the supplemental, but puts the risk fully on IRS—and OMB—if these amounts are not appropriated.

We were not able to send up this notification any sooner because of the very thorough reviews done by IRS, Treasury, and OMB's general counsels on determining the basis for a deficiency apportionment.

Senator DECONCINI. Your deficiency apportionment did not come up until March 18. They had hired more than one-half the people by then, I am told.

Mr. MILLER. We have requested an emergency supplemental for the IRS. It was our expectation, given discussions we have had with various Members of the Congress, that this was very likely to be approved.

Senator DECONCINI. You know, I guess maybe it depends on who you talk to in Congress.

Mr. MILLER. Obviously, you have a different view.

Senator DECONCINI. Obviously, I have a different view. Emergency supplementals are not endangered species. We pass them all the time. I cannot understand why we permit IRS to go ahead with this.

Mr. MILLER. I will just mention that I think you are the first person I have talked to in the Congress who has voiced reservations about that supplemental for IRS. A number of people have beaten me over the head——

Senator DECONCINI. For not getting it up here?

Mr. MILLER. For not getting it up to Congress.

Senator ABDNOR. I remember last year the question we got from some of our own Members of Congress about putting money in, and the next thing, they went along with the veto. Voted on the floor to cut it, people directly involved with the Finance Committee. They wanted all of these bodies.

Senator Domenici put an across-the-board cut on it. My good friend, the Commissioner of IRS, is saying it is going to be Congress' fault if we do not come through, it is our fault, and not his. It does put us on the spot, if you go ahead and hire them ahead of time.

Senator DECONCINI. Mr. Chairman, I am not interested in being destructive, but I am upset about it. If I had my way, I would lay them all off. Sure, it would cause a disruption. But I do not know how you can run a government in that manner.

I would say that about any other committee faced with this.

I have no other questions.

Thank you, Mr. Chairman.

Senator ABDNOR. I might add, Customs', getting off the interdiction part, numbers are going to be like the IRS, and will cause problems in collection.

I wish the Commissioner would speak out louder. We are concerned about it. I think we are going to have trouble doing what we want to do in the collection agency part of it. Like you are talking about with IRS.

What did you say they raised, $15 billion——

Senator DECONCINI. Customs raised $15 million. That would be an interesting thing, if you would supply for the record, Director Miller, with the cuts you put in Customs, how much do you then attribute to lessening the amount of collections?

If you could supply that for the record, I would like to see that. If, in fact, you have made any analysis of the cuts in Customs, and how that relates to Customs divorcing the user fee increase you put in there.

[The information follows:]

The Customs Service is estimating collections of $15 billion in total revenue in fiscal year 1987. This is an increase over the fiscal year 1986 estimate of $13.9 billion and the fiscal year 1985 actual amount of $13.2 billion.

The Customs Service is not anticipating any revenue losses as a result of the reductions imposed by the Gramm-Rudman-Hollings measure or other productivity efficiencies. It is important to note that, unlike the Internal Revenue Service, Customs revenue is not a product of overall personnel levels, but rather a factor of general economic conditions and overall trade relations.

The Internal Revenue Service has been able to analytically document a specific marginal relationship between budget and personnel levels and the amount of tax revenue to be gained or lost. No relationship between Customs Service overall staffing levels and total revenue has been analytically demonstrated.

U.S. SECRET SERVICE

Senator ABDNOR. Let me quickly ask about the Secret Service being involved in antiterrorism, you know, and all the other responsibilities we keep throwing at them.

Before we get through with fiscal year 1987, we are going to have Presidential candidates all over the lot. I think that could cause some problems. I really do, if we are going to carry through with the terrorist programs.

Do you know anything about the possibility of transfer of the protective——

Mr. PARKINSON. There is discussion at this time of transferring the protection responsibility of visitors to the country under a head of State, to the State Department.

Mr. MILLER. There are some other things going on regarding the security of Americans abroad, in embassies, that I cannot go into right now. Our major protection is currently provided by DOD employees that are stationed at the embassy.

But, Senator, on your point about Presidential candidates, my understanding is the Secret Service request for funding would cover that. But if that proliferates, obviously we would have to come up with something else.

Senator Abdnor. We are getting it two ways. Individual requests apparently will come close to that, but the Budget Committee action can cause problems. That is something we better be watching.

I remember when we had to fight like heck to put added dollars into the Secret Service, when the Olympics came to this country. Somebody down there did not think much about the responsibility. That was a Presidential year, too.

That is how we get in trouble with all of the little arrangements because we have to rob Peter to pay Paul, and do it on our own.

Mr. Parkinson just mentioned the protection of the Marcos'. All of these things come up, and these people have an extra burden on them, and it costs dollars.

The rest of our questions, except one, I will submit.

I am getting a little parochial here, but I want to ask you, The President did send Congress a proposal with respect to the funding of HUD, and HUD redevelopment grants, and also section 202 of the Housing for the Elderly and Handicapped Programs. Both programs lapse, I think, about April 15. If that happens, can you confirm to us that these programs will be permitted to go forward for the balance of the year?

Mr. Miller. Well——

Senator Abdnor. Two programs, the HUD urban development, and the other one is section 202 of the housing for the elderly and handicapped.

Mr. Miller. As I said, if the deferral is rejected, we will abide by that. If the rescission is not approved, we will abide by that decision of Congress.

Senator Abdnor. Well, you are a busy man, and it is 11 o'clock. I think we said at 11 we would get you out of here.

Mr. Miller. I appreciate that, Mr. Chairman.

ADDITIONAL COMMITTEE QUESTIONS

Senator Abdnor. There will be some additional questions which we will submit for your response to the record.

[The following questions were not asked at the hearing but were submitted to be answered for the record:]

Additional Committee Questions

Mr. Abdnor: There is currently some discussion that security arrangements for dignitaries visiting the United States that are currently the responsibility of the State Department will be transferred to the Secret Service. Can you give the Committee assurances that the Secret Service will receive adequate funding to cover any associated costs without affecting the Service's other responsibilities?

Mr. Miller: In January 1986, President Reagan approved National Security Directive 207 which will allow for numerous improvements to the way this Administration can respond to terrorist activities. One provision in this National Security Directive would require the Secret Service to assume the responsibility for protecting the accompanying spouses of visiting Chiefs of state and Heads of government by May 1, 1986. This administrative action would place protective responsibilities of these visiting dignitaries and their spouses within one organization. At present the Secret Service protects the visiting dignitary while the State Department currently protects the visiting spouse.

The Administration does not intend to weaken other protective and investigative responsibilities of the Secret Service in order to compensate for this new protective requirement. Staff at the Departments of State and Treasury will be exploring the appropriate level of funding for the Secret Service to undertake this additional responsibility. I expect that there will be adequate levels of budget resources provided to cover the associated costs of this new Secret Service protective requirement.

Mr. Abdnor: Next I want to touch on an issue which may sound like a broken record, but one that is of great concern to this Subcommittee. I speak of funding for Customs. You will recall that I raised my concern with you during the Committee's economic oversight hearings. Nothing has happened to date which has caused me to change my mind. I do not understand why we insist on cutting front line efforts and increase secondary ones. I am not downgrading the job that the FBI and DEA does, but I cannot see that it is cost effective to spend money once the drugs are in this country and that is exactly what this budget does. Before I ask you how you can justify this, I might add that I have just learned that DEA is going to use the extra funding they are getting to create a program to detect planes and boats trafficking in drugs. Customs is doing that. In fact they have just opened a new center in Miami that is most effective and DEA is proposing going in much the same direction. This comes on the heels of a recission you have sent up for the Customs air and marine programs. It is very hard for me to understand what you are doing. Perhaps you can enlighten me?

Mr. Miller: From the outset, let me suggest that the FY 1987 President's Budget is an excellent indication that the Federal drug law enforcement program is one of the top domestic priorities of President Reagan and this Administration. Even considering the fiscal constraints required by the Gramm-Rudman-Hollings measure, the 1987 Budget increases drug law enforcement programs by over $146 million above enacted 1986 levels.

I would respectfully correct the Senator and note that the responsibilities of the Federal Bureau of Investigation and the Drug Enforcement Administration in drug law enforcement are not secondary jobs, but real front line efforts. For example, over ten percent of the entire DEA budget is specifically related to overseas investigations and intelligence efforts that will eventually lead to the drug-pins themselves. Moreover, a specific $9 million increase for the FBI will provide for an artificial intelligence computer program at the El Paso Intelligence Center (EPIC) and will certainly increase the capability of the Federal Government's drug interdiction effort. That effort is aimed at stopping illegal and illicit drugs before it crosses the U.S. borders.

Contrary to your statement, the Administration is not changing the course of the Customs Service budget. Since 1981, budget resources for the Customs Service air and marine interdiction programs have increased by 150 percent (from $40 million to $102 million), nearly double that of law enforcement programs within the Department of Justice and the Secret Service during the same period of time.

The Administration is simply proposing a pause in the previous rapid growth rate of the Customs Service air interdiction budget. The funding levels proposed in 1986 and 1987 are consistent with actual operations in 1985 and will not restrict the Customs Services ability to detect and intercept drug smugglers. I am confident that the Customs air interdiction program will still fulfill its responsibilities as part of the total Federal drug enforcement effort.

By the end of 1986, the Customs Service marine program will be taking delivery of forty "Blue Thunder" marine interdiction vessels. Within the Administration-proposed rescission, only $1.3 million was slated to be reduced from the entire marine program and would not have altered the efficiency and effectiveness of the program.

Finally, I would remind the Subcommittee that the Administration, through the National Drug Enforcement Policy Board, is currently reviewing the entire national drug law enforcement strategy, including drug interdiction efforts. The completion of this drug enforcement strategy evaluation, together with the improved policy oversight and coordination provided by the Board, will assure all of us that the commitment of Federal resources to current drug enforcement efforts in a myriad of agency programs are allocated efficiently and effectively.

Mr. Abdnor: I am concerned with the funding for the Secret Service. In last year's bill we provided $3.6 million for anti-terrorist activities, but the FY 1987 base level doesn't include that level. I realize the lateness of enacting the continuing resolution may have been the major problem, but my major point is to determine if this was considered by the OMB as part of the FY 1987 budget. Could you provide a response for the record?

Mr. Miller: As final 1986 Congressional action was not completed when 1987 OMB budget review was taking place, the $3.7 million was not considered part of the Secret Service base budget.

I would remind the Subcommittee of the strong support that OMB has shown toward the 1987 Secret Service request for anti-terrorist activities, including Presidential candidate protection resources, voice-privacy radio equipment, Presidential protection support equipment and other White House security measures. The FY 1987 Secret Service budget totals $307 million, an increase of $13 million (4%) over the 1986 enacted level. This amount is the second largest bureau increase (next to the Internal Revenue Service) within the Department of the Treasury.

Mr. Abdnor: You note that because of Gramm-Rudman-Hollings OMB will have a greater work load. Now that you have one year under your belt haven't you created a computer model which will ease the work problems caused in the first year? If you haven't, can one be created?

Mr. Miller: Workload associated with Gramm-Rudman-Hollings (G-R-H) will continue on an on-going basis. There was a level of effort associated with the implementation of G-R-H that was one-time in nature and will not continue. However, there is work, which is very labor intensive, that OMB will continue to do. These items include:

a. Continued contact with the various departments/agencies to get updated budget data to factor into the G-R-H process. This data is often collected in different formats and with different assumptions, consequently requiring a level of effort over and above that which would normally be expended.

b. OMB continues to spend a lot of time with the Congressional Budget Office (CBO) and the various departments/agencies in the resolution of conceptual and implementation issues that arise from G-R-H.

c. Even though the G-R-H data base is in place, we need to continue to work on the structure and reporting capabilities to ensure compatability with CBO. Also, since the reporting requirements continue to change we constantly need to reprogram the data base.

d. Finally, the law has different rules that apply to the 1987 sequester than were used in 1986. The requirements of the law as well as environment under which we implement the law is not static and consequently requires effort to update, resolve and maintain the data base.

Mr. Abdnor: How many positions are authorized for OMB? How many are currently filled? How many of those will be filled in 1987 with this budget? Does OMB have detailees from other agencies? How many?

Mr. Miller: OMB is currently authorized 594 full time permanent positions. Currently we have 524 full time permanent employees on board. The 1987 budget request will allow us to have approximately 542 full time permanent positions filled, however, the exact number may vary based upon the actual salary level paid to new employees, attrition and hiring rates, and so forth. OMB currently has 45 detailees on board.

Mr. Abdnor: In your statement you note that you have over 60 vacancies. I don't believe the budget you are requesting will fill those spots. How will these vacancies affect your work schedule?

Mr. Miller: OMB's 1987 request will not allow us to fill all the vacant positions. The work load attributable to the vacant positions will have to be absorbed by the remaining staff members In addition, OMB has a compressed time in which to produce the budget. Since the President's budget will be submitted to Congress the first part of January 1987, rather than February, we must do in three months what we previously did in four months. Failure to fill the vacant positions will complicate our compressed budget season.

Mr. Abdnor: You indicated in your response to an earlier question that Gramm-Rudman-Hollings will cost OMB $500,000 per year. Could you provide the Committee with a breakout of what those expenditures will be?

Mr. Miller: The $500,000 in expenditures associated with G-R-H workload would fall into two categories:

1) Personnel costs totaling approximately $300,000 are associated with OMB staff required to gather additional data from the departments/agencies and personnel costs of OMB staff working with CBO and the departments/agencies in the resolution of conceptual and implementation issues that arrise from G-R-H. In addition, the requirements of the law, as well as the environment under which G-R-H is implemented is not static and consequently requires effort to update, resolve and maintain the data base. For example, the rules/procedures that apply to the 1987 sequester are different than those implemented in 1986.

2) The remaining funds are attributable to expenditure for printing, federal register costs and supplies associated with the G-R-H activities.

Questions Submitted by Senator Frank R. Lautenberg

Mr. Lautenberg: Mr. Miller, at the Appropriations Committee FY 87 budget overview hearing, you could not provide me with a breakout of the expenditures by OIRA for its work under the Paperwork Reduction Act and under the executive orders. You stated that the use of staff and funds for these two categories were completely intertwined. I have become increasingly concerned that OIRA, which has been operating without an authorization for over two years, has concentrated on the executive orders reviews to the detriment of the functions assigned by Congress in the Paperwork Reduction Act.

Can you tell me how much of the FY 87 request for OIRA funding of $5.408 million is for Paperwork Act functions and how much is for the executive orders reviews?

Mr. Miller: Paperwork reduction oversight and reviewing regulations are activities that are inextricably linked. Trimming unnecessary paperwork and making regulations more efficient are usually the same thing. The goal in both instances is to minimize government intrusiveness. Our efforts have increasingly focused on regulatory-driven paperwork burdens because most government paperwork is now the result of regulations. In order to reduce paperwork burdens often the regulatory burden must be reduced.

In other words, we could not carry out our paperwork reduction responsibilities without reviewing agency regulations.

We do not require our analysts to fill out time cards on what activities they work on during the day. It is not possible to tell how much of the FY 87 budget request for OIRA funding will be used for Paperwork Act functions as opposed to executive order reviews. The following example may help explain the difficulty in separating the functions.

During the past year, the Minerals Management Service submitted an information collection request for its payor information form. The data collected with this form drives the Auditing and Financial system, a key component of MMS's royalty management ADP system. MMS also submitted a draft regulation that required the use of this form. OIRA reviewed the paperwork, the regulation, and the ADP system, all as part of the same program.

We could say that these activities fall under the Paperwork Act. We could also say that some of them fall under the executive order review. Determining how much time and resources were attributed to each closely interrelated activity would be difficult and expensive, and this information is not necessary for effective internal management.

We do carry out the President's regulatory program, but we also carry out the Paperwork Reduction Act of 1980. We have active and effective programs underway for each of our major Paperwork Reduction Act responsibilities. We testify constantly on progress in these programs and on implementation of the Act. GAO continually evaluates our implementation. It is not correct to say that we do not carry out our Paperwork Reduction Act responsibilities.

Mr. Lautenberg: How much of the request is for Paperwork Reduction Act functions other than reviews of information requests? This would include primarily OIRA's responsibility to improve and coordinate government-wide automatic data processing and telecommunications activities.

Mr. Miller: Although we integrate our ADP and information policy activities with our paperwork and regulatory review activities, OIRA's Information Policy Branch (13 of OIRA's 68 FTES) and OIRA's Statistical Policy Office (7 of OIRA's 68 FTES) are primarily engaged in carrying out the Paperwork Reduction Act's information policy and statistical policy activities. The other three branches of OIRA (48 of OIRA's 63 FTES) are also involved in these activities but to a lesser extent.

Mr. Lautenberg: Why should Congress fund OIRA for FY 87 if OMB cannot provide a budget showing a breakout of the man-years devoted to administering the Paperwork Reduction Act and the executive orders?

Mr. Miller: The President's Budget request for OIRA for FY 87 should not be denied, we believe, because OIRA integrates its activities as much as possible. We are not required to breakout our expenditures in this way and have no reason to do so. S. 2433, which was considered by the Senate Governmental Affairs Committee during the 98th Congress, contained provisions that we endorsed that would have provided additional data, but that bill was not enacted.

Without funding for OIRA in FY 87, the important Paperwork Reduction Act activities and the President's Regulatory Program would not be carried out by OIRA and some of these activities probably would not be carried out at all.

The President must have assistance to carry out his responsibilities as President. We believe that this President should be provided the funding necessary to carry out his program, just as other presidents have been provided funds for these purposes.

Mr. Lautenberg: Has OMB asked the Congress to reauthorize OIRA, by reauthorizing the Paperwork Reduction Act, for FY 86 or FY 87? Why not?

Mr. Miller: OMB has requested that OIRA be provided authorization for appropriations for fiscal years after FY 83, the last year that appropriations were authorized. In 1983, we supported OIRA's reauthorized appropriations in H.R. 2718, although we objected to other provisions of that bill. OMB supported S. 2433 in 1984. Among other things, S. 2433 would have authorized appropriations for fiscal years 1985, 1986, 1987, and 1988.

In oversight hearings concerning OIRA, in appropriation hearings concerning OMB, and in the Director's confirmation hearings, OMB has made it clear that we supported legislation that would provide further authorization for OIRA.

Mr. Lautenberg: Why is OMB requesting FY 87 funds for an office it is not seeking to have authorized?

Mr. Miller: OMB continues to support and seek authorization for appropriations for OIRA. In the meantime, we believe that OIRA should receive funds for carrying out the Paperwork Reduction Act and Executive Order Nos. 12291 and 12498.

Mr. Lautenberg: Under the executive orders, OMB's objections to proposed rules are privately made before a rule can even be published for comment. If rules clear that hurdle, OMB then gets a second chance to object in private before the rulemaking agency can issue a final rule.

At the front end, doesn't this stifle the public comment process before it can take place as mandated under the Administrative Procedure Act? Shouldn't the rulemaking agency be permitted the benefit of all other public comments on the proposed rule, to be considered along with any OMB objections as part of a democratic public rulemaking debate?

Doesn't OMB unnecessarily delay the process at both ends? First, publication to solicit comment is delayed while the agency, in private, has to deal with OMB's objections. Then, after considering the public comments made in the sometimes extensive rulemaking proceeding, and deciding on a final rule, the agency has to delay for OMB's comments and continue to delay to consider and answer OMB's objections, usually in private.

Mr. Miller: The President's authority to (1) instruct his appointees as to how to exercise discretionary authority vested in them by law; (2) require that these appointees submit regulatory proposals to him; and (3) require OMB to review these proposals and advise the appointee whether they comport with the President's regulatory principles -- the basic tenets of E.O. 12291 -- is derived from the President's constitutional authority and, implicitly, from the laws of the United States that vest authority in the Executive branch. Executive Order No. 12291 specifically provides that it does not displace the authority of an agency head that is assigned to him or her by law. There is no rulemaking-decision authority vested in the Director of OMB by E.O. 12291.

You ask whether the OMB review before a proposed rule is published doesn't stifle the public comment process before it can take place as mandated under the Administrative Procedures Act. The APA does not require public comments on or during the process of developing a proposed rule. Public comment occurs after a rule is proposed. OMB review does not change this. What a proposed rule will provide is usually committed to agency discretion, to be carried out consistent with the authorizing statute. The President in Executive Order No. 12291 has instructed his appointees in exercising whatever discretion they have to follow the regulatory principles in Executive Order No. 12291, and has asked us to review whether they have done so. Public comment is not stifled by the Order.

OMB does not provide public notice of its reviews or provide the public with an opportunity to comment on the agency proposal. That is done by the agency. The public comment process is not stifled. The public has full access to how the agency proposes to regulate, and is free to provide comments as it sees fit, as required by the Administrative Procedure Act.

Under E.O. 12291, OMB's role is "advisory and consultative," the regulatory authority of agency heads is not displaced, and the rule must be supported -- in fact, must be based upon -- the agency "record." Criticism focusing on OMB's private review misses the point because information that is not part of the agency record cannot determine the outcome of the regulatory process. The ultimate result of the rulemaking process must be a decision for which there is a rational and reasoned basis in the record. Nonrecord evidence cannot be used to support a rule, and any decision not anchored in the record will be overturned.

You also asked about possible unnecessary delay in the review of agency regulations. OMB's Office of Information and Regulatory Affairs (OIA) reviews the regulatory actions of executive agencies, in order to determine consistency with the President's regulatory principles. OIRA has, as of December 31, 1985, reviewed under Executive Order No. 12291 over 5,100 proposed agency rules and over 7,000 final agency rules -- a total of over 12,100 rulemaking actions. This averages about 90 proposed rules and 125 final rules per month.

Executive Order No. 12291 provides 10 days for OMB review of non-major rules. For major rules, the Order affords 60 days of review for proposed rules, 30 days for final ones. All of these review periods may be extended by notice from OIRA to the agency concerned.

From February 1981, when President Reagan signed Executive Order No. 12291, to December 31, 1985, the statistics from OIRA E.O. 12291 reviews were as follows:

* OIRA reviewed a total of 331 "major" rules from all the Departments and agencies subject to the Executive Order. Reviews of "major" proposed rules averaged about 43 days; reviews of "major" final rules averaged about 26 days. Reviews of all "major" rules averaged 32 days.

* OIRA has reviewed a total of 11,914 non-major rules under E.O. 12291 in an average of 16 days.

* 81% of all rules were reviewed in 10 days or fewer; 90% were reviewed within 30 days.

* The number of rules reviewed annually has declined slightly -- from 2,803 in 1981, to 2,211 in 1985.

* The percentage of all rules returned, withdrawn, or changed by the agency in order to assure consistency with the President's regulatory principles has increased each year -- from 8.3% in 1981 to 29% in 1985.

* The average review time has increased from 9 days in 1981 to 28 days in 1985.

OIRA monitors closely both the rules under its review and the length of time it takes to review them. OIRA is concerned that the reviews not take too long. On occasion they do, but OIRA tries to limit those occasions. It can often take from two to as many as eight years for an agency to develop a rule. The number of protracted rulemakings have been few, especially in light of the large number of draft rules OIRA has reviewed.

Mr. Lautenberg: An example of this inefficiency and delay of needed health and safety protection caused by OMB is the grain dust standard, which after years of hearings and attempts by OMB to water it down, is still bottled up in OSHA, while elevator explosions due to dust levels continue at an alarming frequency.

Mr. Miller: OSHA's proposed grain-handling rule was an extremely complex and detailed standard which attempted to address the multiple causes of fires and explosions, as well as other hazards such as suffocation and falls, in grain-handling facilities. The rule proposed to cover 16,000 facilities ranging from enormous export elevators with storage capacities of tens of millions of tons and hundreds of employees to small country elevators with storage capacities of tens of thousands of tons and two or three employees. The rule also covered feed mills, grain processing facilities, and oil seed processing facilities. In our review of OSHA's original regulatory impact analysis as well as the voluminous public record, many questions arose concerning the accuracy of OSHA's data and the reasonableness of the agency's assumptions. The problems that OMB found led OSHA to decide to hire a second contractor to prepare a new regulatory analysis. Our questions and OSHA's new analysis led to the development of a proposed rule which raised for public comment a broader range of compliance alternatives. Because many of our concerns remained unaddressed when the proposed rule was published, however, OMB submitted its comments on OSHA's proposed rule to the public record on April 11, 1984.

In the past 18 months, OSHA has conducted public hearings on this standard, and has continued to carefully assess over 4,000 comments which have been submitted to the public record. The Department of Labor has indicated that this rulemaking will be completed in 1986. This rule has not been reviewed by OMB since December 21, 1983, the date OMB concluded review of the proposed rule on grain handling. To date, OSHA has not submitted the draft final rule for OMB review. We are not "blocking" OSHA's progress in issuing this rule.

SUBCOMMITTEE RECESS

Senator ABDNOR. I want to thank you for your participation, and if there is no further business to come before the subcommittee, we stand in recess until April 16, at 2 p.m., when we complete this year's hearings with the testimony from the public witnesses.

[Whereupon, at 10:59 a.m., Thursday, April 10, the subcommittee was recessed, to reconvene at 2 p.m., Wednesday, April 16.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1987

WEDNESDAY. APRIL 16, 1986

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:20 p.m., in room SD-124, Dirksen Senate Office Building, Hon. Mack Mattingly presiding.

Present: Senators Abdnor and Mattingtly.

NONDEPARTMENTAL WITNESSES

U.S POSTAL SERVICE

OPENING REMARKS

Senator MATTINGLY. The subcommittee will come to order.

This afternoon the subcommmittee will complete our oversight hearings on the fiscal year 1987 budget with testimony from the public witnesses.

We'll dispense with their opening statements for we have a number of witnesses and we'll certainly have a full afternoon because of the number of witnesses.

I would ask that each of you keep your oral presentation to 5 minutes. I will state that the entire written text of each statement will be made a part of the record.

We'll open today's hearing with the panel witnesses who are interested in the funding level of the revenue foregone subsidy.

I would ask Father William L. George, representing Georgetown University and Mrs. Link of the Children's Television Workshop, Sally Wells representing the National Association of Public Television Stations and Mr. Joe Thomas of the Alliance of Nonprofit Mailers join as a panel.

STATEMENT OF FATHER WILLIAM L. GEORGE, S.J., SPECIAL ASSISTANT TO THE PRESIDENT OF GEORGETOWN UNIVERSITY

Father GEORGE. Well, Mr. Chairman, I am Father William George, assistant to the president of Georgetown and I thank you. This is my first time to testify before the Treasury, Postal Appropriation Subcommittee.

It's an unusual circumstance that brings me here as I am not going to ask for any money, so it's not as difficult as it could be.

In 1989, the country will celebrate 200 years of Catholic higher education and Georgetown happens to have been the first institution of Catholic higher education in the United States, so we take great pride in that.

We're going to submit, before the Postal Advisory Commission, a request that they commemorate the event and I just really wanted to inform the committee that we were going to do that.

About 600,000 students throughout the United States attend Catholic higher education this very day. And, as Georgetown was the first as well as chartered by Congress, we usually keep you all informed what we're up to. We're going to try and make a presentation to them and as we come up with drafts, I'll inform the staff and Committee of what we're doing.

PREPARED STATEMENT

So, we would like to seek your assistance and support, whatever that could be and thank you for the opportunity to let you know and testify.

Senator Mattingtly. Thank you.

[The statement follows:]

STATEMENT OF FATHER WILLIAM L. GEORGE, S.J.

Mr. Chairman and members of the committee, I am Father William L. George, S.J., special assistant to the president of Georgetown University. Thank you for the opportunity to speak today about an important anniversary in U.S. history that will be celebrated in 3 years.

1989 is the anniversary of 200 years of Catholic higher education in the United States. The first institution was founded on the banks of the Potomac in 1789 in the Nation's Capital, chartered by the First Congress. The founder was John Carroll, a member of one of the most significant American families during the Revolution. John Carroll was both a statesman, an envoy of General Washington, and a prelate, the first bishop of the United States.

We would ask that the committee assist in whatever way it can to commemorate such a nationally historic event.

Today there are 235 Catholic colleges and universities in the United States, enrolling nearly 600,000 students. Millions of graduates of Catholic institutions of higher learning serve and work in every walk and clime of American life. Primarily undergraduate institutions, Catholic colleges and universities range in size from 100 students to over 20,000, and are located in 46 States, the District of Columbia, and Puerto Rico. Catholic higher education has educated large numbers of this country's immigrants and continues to attract students and faculty from diverse backgrounds and cultures. Approximately 16 percent of the students enrolled are members of various U.S. ethnic groups. Women now constitute over 53 percent of the total enrollment in Catholic higher education. Clearly, Catholic higher education is an integral part of our Nation's educational system.

In 1989 our country will celebrate the 200th anniversary of the U.S. Constitution, the first Presidential election, the First Congress, and the Bill of Rights. Incidently, 1789 was also the year of Adam Smith's "The Weatlh of Nations," and the French Revolution. We add to these significant anniversaries the celebration of 200 years of Catholic higher education in the United States. To help commemorate this auspicious occasion we will propose that a postage stamp be commissioned. It would be appropriate that the colors of this commemorative, bicentennial stamp by blue and gray, the official colors of the first Catholic University which were adopted at the end of the Civil War, signifying the union of North and South.

We seek your assistance and support in this proposal celebrating 200 years of Catholic higher education in the United States.

On behalf of Rev. Timothy S. Healy, S.J., thank you for this opportunity to testify.

STATEMENT OF NINA B. LINK, VICE PRESIDENT/PUBLISHER, CHILDREN'S TELEVISION WORKSHOP

Ms. LINK. My name is Nina Link and I am vice president of Children's Television Workshop [CTW] and publisher of our three magazines, Sesame Street, Electric Company, and 3–2–1 Contact.

Children's Television Workshop is a 501–C–3 nonprofit organization. We're dedicated to high quality television and support in the area of print.

The magazines are designed to promote literacy. They are often the child's first experience with print and they very much support the material on our television shows and we also hope to contribute back to help produce the television shows of our parent company, Children's Television Workshop.

We hope that the nonprofit postal rates can be maintained at their present, sufficiently low level to allow us to continue our mission of education and support. The two increases that we have had this year have really hurt us badly and further increases could possibly bring our publishing mission to a halt.

We have a circulation of over 2 million subscriptions throughout the country and a readership of over 6 million children and adults. There are many parents and children who go through our magazines together

Sesame is for children aged 2 to 6 and it has a preschool curriculum in the areas of reading, math, science, and socialization, preparing kids for school.

Then we move on to Electric Company magazine which is for children 6 to 11 and has stories, games and puzzles to motivate children to read and reinforce many things they are beginning to learn in school.

Contact is our science and technology magazine for children aged 8 to 14 and really to expose them to the world of science and prepare them for the ever changing world around them. We were pleased to hear last week that 3–2–1 Contact is a finalist in the National Magazine Awards, the only youth magazine represented in the area of general excellence.

The readers of all our magazines are very active and vocal about how they use our magazines and send us many appreciative comments from thank you for many hours of fun and the experiences and guidance your magazine provides—to what a wonderful magazine. I'm happy it's not the kind of magazine that is read and tossed out. Instead, I can go back to it over and over again.

I guess my favorite letter is from a Contact reader, a young gentleman who said:

> I want to tell you how much I like your magazine. I have only gotten seven issues but I think it is fantastic. It's not just me that likes it, it is the whole family. In fact, I want my birthday cake to say 3–2–1 Contact. Keep up the good work.

Our magazines receive no government or corporate funding and our primary source of revenue is from subscriptions. We have been able to maintain pretty competitive with other magazines. But, further increases in postage are going to really seriously hurt us.

Testing that we have done has shown that if we try to increase our subscription rates significantly, we will see a marked decrease in the number of subscribers responding.

Here are the facts about postage for Children's Television Workshop to give you some idea of the scale of the numbers for us. Until January 1986 our annual postal bill, under step 14, second-class and third-class nonprofit rates would have been $2,407,000. The move to step 16 in January increased our annual postal bill 22.4 percent to $2,945,000, a jump of $538,000. Then again in March 1986, we had yet another increase and that brought our annualized postal bill up to $3,227,500, an additional increase of $282,000.

How are we going to make up for the loss of $820,000 in the past 90 days, the difference between step 14 and our present postal rates?

What would happen if there were no subsidy for nonprofits? Our postal bill at CTW would skyrocket to $4,019,000 and what would happen is that Sesame Street, Electric Company, and 3–2–1 Contact could no longer be published.

As many of you know, our television shows carry no advertisement and in the past neither have our magazines. But, 6 months ago, we we forced to begin to take limited advertising in our magazines to make up for some of the lost revenue. The rising postal costs really gave us no alternative. We have a very strict advertising policy and we are trying to keep the number of pages limited. The advertising does not cover our costs, but it does make us able to continue publishing at this time. This may not be the case if there are substantial postal increases again in the coming year.

PREPARED STATEMENT

Use of nonprofit has made it possible for us to provide magazines of high quality with important educational value. We hope you will allow us to continue to do so by appropriating sufficient revenue foregone funds. Thank you.

[The statement follows:]

STATEMENT OF NINA B. LINK

My name is Nina Link. I'm Vice President of the Magazine Group at Children's Television Workshop, and Publisher of Sesame Street, Electric Company, and 3-2-1 Contact magazines. Children's Television Workshop is a 501-C-3 non-profit organization dedicated to production of high quality educational television programs for our nation's children. Our magazines are designed to promote literacy, to provide parents, children and teachers with additional support material related to our TV programs, and also to contribute necessary revenue to help produce those programs.

We sincerely hope that non-profit postal rates can be maintained at sufficiently low levels by means of adequate revenue foregone appropriations to permit us to accomplish our objectives of education and support. The two increases this year have already hurt us badly and further increases would bring our mission to a halt.

Our circulation numbers more than two million households a month with a readership of over six million children and adults.

Sesame Street Magazine is for children aged 2 to 6 and provides prereading, premath, prescience, socialization and affective curricula to help children prepare for school and begin to explore the world around them. It includes a Parents' Guide to bring timely and useful information about parenting.

The Electric Company Magazine reaches children 6 to 11 and provides stories, puzzles, games and poems to motivate children to read and to reinforce many of the skills they are learning at school.

3-2-1 Contact Magazine was created for children aged 8 to 14 to expose them to the exciting world of science and technology, prepare them for the ever changing world around them and to involve them in activities which teach and reinforce science principles appropriate to their age.

The readers of all three magazines actively voice their approval by sending in stacks of mail with appreciative comments. For example, the parent of a Sesame Street subscriber wrote:

> "Thank you for the many hours of fun that your magazine has given us. We are looking forward to many more learning experiences using our imaginations and the guidance your magazine provides."

Another parent wrote:

> I have just bought Sesame Street Magazine for the first time for my son... What a wonderful magazine! I am especially happy it is not the kind of magazine that is read from cover to cover, then tossed out. Instead it is a magazine he can look at over and over and learn more and more as he gets older."

From a young Electric Company reader:

> I really enjoy reading the Electric Company Magazine and working all the fun games. I thought I should tell you how much fun it is to relax and sit down to read my Electric Company Magazine because it gives me something to do instead of watching TV all the time."

A parent wrote:

> "Saying goodbye to Electric Company Magazine is like saying goodbye to an old friend. My daughter's reading greatly improved when she was about seven. We have enjoyed the riddles, games and stories. Thank you for your excellent magazines. Thank you for all the memories and smiles."

Our 3-2-1 Contact readers are particularly emotional about the magazine:

> "I love your magazine. Every time I get it I learn more and more. I never thought a magazine could be full of this much stuff. It keeps me busy for hours. When I start to read it I can't put it down."

> " I want to tell you how much I like your magazine. I have only gotten seven issues but I think it is fantastic. It's not just me that likes it, it's the whole family. In fact, I want my birthday cake to say 3-2-1 Contact. Keep up the good work."

Since our magazines receive no government or corporate funding, our primary source of revenue comes from subscriptions. Up until now, our subscription and newsstand rates have been competitive with other children's magazines. But, we'll be fighting a losing battle if we have to increase our rates much further, to offset the losses from postal rate increases. In-depth testing has shown that further increases will sharply reduce our subscription base. That, in turn, will reduce our revenues and our ability to put out the high quality magazines that millions of parents have come to expect and rely on for their children..

Here are the facts about postage costs for the three CTW Magazines. Until January, 1986, our annual postal bill under Step 14's second and third class non-profit rates would have been $2,407,000. The move to Step 16 in January, 1986 increased our annual postal bill 22.4% to $2,945,000, a jump of $538,000. The impact of the March 9, 1986 increase will bring our annualized postal bill up to $3,227,500, an increase of another $282,000.

How will we make up for this enormous loss of $820,000--in the past ninety days--the difference between Step 14 and our present postal rates? What would happen if there were no subsidy for non-profit organizations and our postal bill suddenly skyrocketed to $4,019,000? Here's what would happen...Sesame Street Magazine, The Electric Company Magazine and 3-2-1 Contact Magazine would be in immediate jeopardy.

As many of you may know, our television programs on public television carry no advertising. We have always been very careful not to violate the confidence that America's mothers and teachers have placed in us, our television programs and our magazines. However, just six months ago, after a long and painful period of study, we began accepting selected types of appropriate advertising in our magazines. Rising postal costs gave us no alternative. By no means does this advertising cover our magazines' costs; but the additional revenue does make it possible for us to continue publishing and mailing them. That may not be the case if there are substantial postal increases again in the coming year.

Use of the non-profit rates has made it possible for us to provide magazines of extremely high quality, with important educational value. We hope that you will allow us to continue to do so by appropriating sufficient revenue foregone funds.

STATEMENT OF SALLY WELLS, SENIOR VICE PRESIDENT FOR DEVELOPMENT AT WETA

Ms. WELLS. Senator Mattingly, I am delighted to be here. My name is Sally Wells. I am senior vice president for development at WETA which is the public television and radio station licensed in the District, but serving also Maryland and Virginia.

The special postal rates are extraordinarily important to us and other nonprofits. We reach an enormous audience in the course of a week. In an average week at WETA, on television, we reach 700,000 households and an average week, on radio we reach 250,000 people. On channel 26 for TV, we have noncommercial top quality programming. During the day we run many of the children's programs that are provided by CTW, that's "Sesame Street," "Mr. Rogers," "3-2-1 Contact." We are really helping children before they get to school get ready to read and have greater language skills and, you know, have a head start as they get into the school system. We don't have violence on those programs and I can't tell you how many mothers and fathers call us and thank us for that.

We do many programs that have to do with making life, maybe better and maybe stop some bad things. We do programs like the "Chemical People" which addressed drug and alcohol abuse. We are about to do one on adult literacy and another one on the aging and what's going to happen as the population grows older and older. And, as we get into prime time, at night, we have dramas of every sort by always top quality. They could be anywhere from Anne of Green Gables and Huckleberry Finn and Shakespeare to the most up-to-date American drama that you will find.

We are also very heavy on nature and environmental programs and scientific documentaries that might be anywhere from outlining the history of Albert Einstein on down to the last fine detail about how a polar bear lives

On WETA radio, we are primarily a news and information station with a very heavy classical music component. But, we also air programs every week from the National Press Club and we do jazz and folk music and lots and lots of news and finally we do "Prairie Home Companion" with the ever popular Garrison Keller.

The thing that we are noted for on both radio and television is news and public affairs of which we go into great depth and one day we may be reporting on what is happening in the Philippines on the crisis of the *Challenger* shuttle or what today is going on in Nicaragua or Libya.

The hallmark that we do have though in news and public affairs is that we require our audiences to think. We try to give both sides and we don't give them the answers and that, I guess is one of the things that's best of all.

Some of the new things that we are doing, as both a national and a local station, is that we are producing right at this minute with the BBC, a nine 1-hour program series on Africa. It's about sub-Saharan Africa. The host is an African named Dr. Ollie Mazruli. To my knowledge, it is the only program ever done on anybody's television about Africa that is hosted and narrated by an African.

Now, having said a little bit about who we serve and what we serve, let me say that WETA gets 71 percent of its operating budget from membership contributions. We get those by asking people in this market to make contributions. We're proud of the fact that our entry fee is $20, which means that if you pay $20, you're a member of both TV and FM. It's one of the lowest in the system and we think it makes almost anybody able to get in.

We have 140,000 members in this region alone and we serve well over 1 million people each week. Now, how do we get those people? Well, we have a direct mail program that has been in place and has been evolving and changing and getting better all the time, but it's been in place for about 20 years. About 75 percent of the income we get from members comes by the mail, either in the sense that we send it out or it comes back and 25 percent comes by the on-air appeals, one of which you saw not too long ago on channel 26 and we have one coming up starting this weekend on radio. It is very, very important to us—the mail.

Another place where we use the mail in a heavy way is by the delivery of Dial magazine, which is the publication of 13 other public television stations and our own, to tell our members, viewers, listeners, what's coming up in the next month. We send out 1,600,000 issues annually and I should say that, although the information on the television is very, very important, but in radio it's particularly important because in this particular market, you cannot get radio schedules in the newspaper. They just aren't printed. That is pitiful.

I should say that much as in the CTW publications, the Dial takes ads, but they by no means pay for the cost of the Dial magazine which does report to those members. So, it helps, but it's not enough.

I mentioned that 71 percent of our operating budget comes from the members. Let me add to that we get another 4 percent from the Federal Government which is unrestricted and we get a fair amount of restricted money that goes directly to programs that we produce for the whole system. "MacNeil-Lehrer Newshour," "Washington Week in Review," "Capitol Journal," "Smithsonian World," lots of documentaries, a fair number of music and performance programs and so forth.

I should add that we get no money from the District of Columbia, Maryland, or Virginia. It's very unusual. Almost all stations across the country do, but we don't. That means that every year we start from zero to budget. The only really reliable source of income that we get to run those two stations, day in and day out comes from membership We would literally go out of business tomorrow without those members and as I mentioned, we get most of that income through the mail.

Our postage costs this fiscal year, we predict will be $330,000. In the past 3 years, that amount of postage has doubled. It scares us to death because it hurts our ratio of income to expense. The higher that goes up, the less we get to keep of it.

One thing that we do in the mail is that we do all of our own mailing. We do approximately 2.5 million pieces a year. We do all the work, all the planning, all the marketing. Nobody on the outside gives us money for that.

As a result, we may incur all the costs, but we also get all the income.

I want to add a few more things about the viewers and listeners; 25 percent of them give voluntarily each year, those who take advantage of the service. It's a very high ratio. And, although that means 75 percent don't give, the fact is that in this market, the people in the District of Columbia, Maryland, and Virginia have responded again and again and again to our mail requirements not only for renewals but extra contributions, and they do it because they like the programs.

We truly hope that we can keep the special postal rates and the subsidies. We don't know what's going to happen to us with Gramm-Rudman. We feel that it's probably going to hurt. We benefit from lots of other Federal Government grants that are almost always restricted from the two Endowments, arts and humanities from the National Science Foundation, Department of Education and the only one that is unrestricted are the Community Service Grants from CPB. In any case, that's going to impact on us as well. We hope that we do provide, day in and day out, to well over 1 million people, enriching and entertaining and highly educational programs without violence. We hope that you can help us keep doing that. Thank you very much.

Senator MATTINGLY. I was interested in your comment that the newspapers won't print——

Ms. WELLS. Radio.

Senator MATTINGLY. Radio schedules, thank you. I was interested to hear you mention the program, the "Chemical People" because my wife and Senator DeConcini's wife are very involved in the congressional families for drug free youth. "Chemical People" is an outstanding example of the educational effort that's going on. I know your magazine has some antidrug messages, as well.

Ms. WELLS. Yes; we do.

Senator MATTINGLY. So I was very glad to hear that.

One thing I wanted to ask about the fundraising appeals—do you think if you did more on TV that it would be beneficial?

Ms. WELLS. No; the reason I'll say no is that the TV is wonderful to get new members, which we need just constantly. Again, we're in a market where people move like fury. The reason the TV is good is that you're talking directly to the people who use the service. So, it's efficient. However, it's much more expensive than the mail.

Now, when you get into the mail, you're into a shotgun situation where you're hitting millions of people in hopes that you will hit a fair number that actually use that service know what you're talking about. But the difference in cost is unbelievable.

Senator MATTINGLY. Well, we would probably send a contribution to you, my wife and I, except when we tune in—we live in the District—the reception is so poor we can't see the picture.

Ms. WELLS. That's another pitiful problem—a pitiful problem of having a U instead of a V.

Let me say just one more thing. We really need to do both, the on air and the mail because we have what we call readers and they respond to the mail and others that respond to the personal, which feels like personal when you're on the air.

Senator MATTINGLY. Thank you all very much. It's been very interesting. I wish I could stay.

Senator ABDNOR [presiding]. Thank you, Senator Mattingly. I appreciate you're being here.

[The statement follows:]

STATEMENT OF PETER M. FANNON, PRESIDENT, NATIONAL ASSOCIATION OF PUBLIC TELEVISION STATIONS

Summary

The nation's public television stations -- all non-profit, non-commercial operations -- are dependent on the postal service as a vital means of communication with their viewers and supporters. These stations utilize second, third, and fourth class non-profit postal rates to help fulfill their mission to provide important educational, cultural, and informational programs to the nation's homes and classrooms. Program guides, tape and printed material and fund solicitations are all sent by public television stations using the non-profit federal postal subsidy.

In the past 70 days, non-commercial stations have been faced with a 50% increase in their mail costs. If the postal subsidy is phased out entirely, as proposed in the Administration's FY1987 budget, our stations would face another 50% increase, and untold escalating increases in the years to come. If the stations' postal costs increased by another 50%, the estimated $5.6 million that they would have to commit for postal expenses would definitely result in hard choices in their individual programming schedules and educational services.

Individual contributions are vital income source

Support from individual viewers or member/subscribers is currently the fastest growing sector of public television's income. This is due in part to renewal support among loyal viewers as a reaction to past federal budget cutbacks, and in part to the stations' use of more sophisticated fundraising techniques. Between 1981 and 1984, public television's total income from subscription increased by 40%. This income now comprises the second largest share of support for public television, after state government support. Over 20% of public television's operating funds, nearly $160 million, comes from these individual contributions.

Over the last two years, public television stations reported all-time records for their recent fundraising "festivals" in terms of the total number of viewer pledges, total dollars pledged, and the value of the average contribution. These record levels have been achieved despite the reduction of on-air fundraising hours by some stations in response to viewer request. Many of these stations are now having great success by promising viewers fewer "pledge breaks" between programs if goals attained by direct mail solicitations for new supporters are met early in the fundraising drive. What this has meant, and will continue to mean, is a growing reliance on reasonable second and third class non-profit postal rates for fundraising purposes.

Direct mail is a proven successful fundraiser for public television

While on-air fundraising is consistently recognized as the best means to attract new subscribers to individual stations, the fundraising effort seen on the air must be accompanied by consistent follow-up through the mails. In FY 1986, public television stations expect to spend an estimated $3.7 million on solicitation mail on about 46 million letters and follow-up materials mailed at the third class non-profit rates. (See attached table)

Non-commercial stations use direct mail fundraising solicitations within their own television coverage areas -- usually about a 50-mile radius. One-sixth of all the new subscribers to public television contribute in reposnse to these letters. The dramatic increases in postal rates that our member stations have swallowed in the past three years have caused problems for both small and large stations.

In non-urban areas, these rate increases do not "pay for themselves" with more successful responses. Since these stations do not mail solicitations outside their own coverage areas, they cannot increase their contributor base. Thus, cost increases usually translate into reductions of funds available for other activities.

For larger stations like WNET/New York, which last year sent out over 7.5 million pieces of direct mail fundraising letters, the unpredictibility as well as the frequency and size and recent postal increases, has hindered fundraising efforts. The lead time on their large scale mailings is considerable, and often the most important postage cost element is unknown and subject to change almost up to the date of the mailing. Another alarming side effect of the increasing cost of raising funds is the increase in the price of a station membership -- and the benefits associated with it -- at some stations. As this membership price rises, the number of contributors naturally becomes depressed. In our stations' experiences, the chances of raising other dollars -- from corporations, foundations, and governmental institutions -- are enhanced by a steady growth in the total number of members. Having to raise these prices and reduce the number of donors will bring extra diffculties to fundraising in these other areas.

Mail provides important information about public television

Crucial to fulfilling federal mandate and maintaining viewer support is the mailing of station program magazines and viewer guides. They are the primary means of keeping viewers informed, as well as meeting the requirements of the Public Broadcasting Act of 1967 to develop public awareness of and disseminate information about public telecommunications services. Public television stations mail over 49 million guides to viewers annually, at a cost in postage of about $4.3 million. Increases in second class postal rates have caused a number of stations to switch to third class mail for their monthly program information bulletins and guides. Although less expensive, third class mail is less reliable for the delivery of such time-sensitive material. The stations make a sacrifice either way -- they pay more and make adjustments elsewhere or take the lower rate and pray for timely delivery.

Our stations are heavy users of fourth class mail as well, sending virtually thousands of audio and video tapes and printed materials to schools and to other stations. Over 200 of our stations provide instructional programming to elementary and secondary schools. Around 600,000 teachers annually receive necessary schedules, teacher guides, and instructional television newsletters sent at the fourth class rate. Overall, we estimate that over four million mailings are affected by fourth class increases, adding another $3.1 million cost to our total.

Here in the Washington metropolitan area, WETA -- channel 26 public television and public radio station 90.9 -- depends heavily on the mail at non-profit rates to sustain their operations. Membership contributions account for 71% of their annual operating budget. Of these contributors, 75% are reached through the mails and 25% through on-air solicitations. WETA will reach over 145,000 member/subscribers by June of this year. Each will receive monthly copies of the DIAL magazine containing the station's television and radio program listings. WETA's costs for non-profit postage for these mailings -- program guides and solicitations -- totals over $337,000. As a station on whom the rest of our stations rely for producing programs for national distribution, any increase in WETA's fundraising costs may have an effect on their production ability.

Another heavy user of the mails is KCET/Los Angeles, a station watched by over 2.2 million families per week, and contributed to by over 200,000 viewers per year. KCET mails 2.8 million program guides per year, and another 4.5 million pieces of fundraising mail. The station estimates that their mail costs could rise by close to $400,000 if the postal subsidy were terminated. To give an idea of how this $400,000 could be put to use by the station, KCET spends $55,000 per year to provide Sesame Street to its viewers, $12,000 per month to pay for electricity for the station's transmitter, $200,000 to produce one of their award-winning public affairs programs KCET Journal, and $100,000 to purchase a year's worth of the program McNeil-Lehrer Newshour.

For the smaller non-commercial stations, the total postal costs may not be as great, but the effect of increasing them is just as diffcult. For example, the South Dakota Network currently spends $16,800 per year to send out its monthly program guide, and $12,000 to send out fundraising solicitations, for a total of $28,800 in postage per year. Like many other public television stations, the South Dakota stations find that when funds are particularly tight, local program production is one of the first casualties. South Dakota produces almost 300 hours of local programs per year, including the agricultural programs Midwest Market Analysis, Agline, and Gardenline, and a public affairs program Statehouse. The network could pay for the production of almost seven months of these programs with the $28,800 they currently pay in postage.

Station KUAT/Tucson, under current non-profit rates, will spend $3,060 to mail its program guides this year, $12,600 on "membership maintenance", or subscription renewal mail, and $7,500 for direct mail to potential new contributors. Any large increase in their mail costs could be devastating to their station's ability to purchase program from the national program schedule or to produce their own, such as the popular Arizona Illustrated.

The effects of increased non-profit postal rates would be devastating to one of public television's youngest stations, KNPB/Reno. This year, KNPB will spend at least $10,713 to send

74,000 program guides, 33,000 fundraising letters, and 70,000 direct mail solicitations. Nearly 70% of KNPB's operating funds come from local contributions, most of them from individual station memberships. Any cutback in the station's attempts to gain more contributions would cut to the heart of their activities.

Conclusion

Just as public television stations are beginning to bring in record levels of support from their audiences to compensate for other losses in revenue, they are having to face cuts from other sources that have a direct impact on the funds they can raise. The total system's figures are devastating enough, but taken on a station-by-station basis, what may seem like a small amount of money represents programs, personnel, and the overall excellence that each station wishes to continue.

We would ask this Subcommittee to do all in its power to recognize the widespread ill effects that the elimination of the non-profit mail subsidy would have on public television stations and their audiences. We urge the Subcommittee to appropriate funds sufficient to maintain these postage rates at least at current levels.

STATEMENT OF JOEL THOMAS, PRESIDENT, ALLIANCE OF NONPROFIT MAILERS

Senator ABDNOR. Mr. Thomas, we have kept you waiting, and I'm sorry. Maybe we saved the most important for the last.

Mr. THOMAS. Thank you very much, Mr. Chairman. I appreciate the opportunity to speak to you today on behalf of the 81 member organizations of the Alliance of Nonprofit Mailers. We represent over 43 million members and volunteers in 86,000 chapters and affiliated organizations across the country. Each of these members look to the decisions that you in this committee will be making in the next few weeks with profound interest.

As we all know, the country is embarking upon a fresh effort to curb the Federal deficit that has grown to unprecedented proportions. Yet we must also, we believe, strive to provide the necessities to those that require assistance. The administration suggests that we should place more reliance on the good works of the private sector to achieve our social and humanitarian goals.

Our member organizations and other nonprofit entities supply a considerable share of the social services, health care, education, research, arts, culture, community improvement, and public advocacy activities which our Nation enjoys.

The organizations represented by the alliance agree with the President who said:

> The American people are deeply proud of this long tradition of neighbor reaching out to neighbor with a helpful hand. In the continuing need that you solve community problems, the compassioned actions of the private sector reflect the sense of essential decency and concern that is so often been a hallmark of our national character. Truly there is no finer expression of the values we cherish than our united efforts to address problems through the creativity and initiative of the private sector.

The majority of people find that organizations are necessary to guide and direct their volunteer impulses and give them continuity. Strong organizations are built upon effective communications. It is, therefore, vital that members and volunteers be kept informed so that private contributions can be channeled to necessary avenues of need and efforts to achieve worthy goals are effectively realized.

Congress recognized the importance of effective communication by charities as early as 1952 and further sought to foster and nurture the volunteer impulse in 1970 when the Postal Reorganization Act was passed. The revenue foregone payment to the Postal Service, built into the act, leverages greater efforts in behalf of the society by private sector nonprofit institutions, their members and volunteers.

In June 1984, because of the longstanding national policy of providing low postal rates to nonprofit organizations had come into jeopardy, the alliance established its preferred rate study panel to examine the status of preferred postal rates.

The panel consisted of the Honorable Gale McGee, former chairman of the Senate Post Office and Civil Service Committee, the prime sponsor of the Postal Reorganization Act of 1970; Mr. Cy Brickfield, the executive director of the American Association of Retired Persons; the

Honorable J. Edward Day, former Postmaster General of the United States; the Honorable James M. Hanley, former chairman of the House Post Office and Civil Service Committee, and the Reverend Richard Knuge, then president of the National Catholic Development Conference.

The panel concluded that—we have provided, in the past, by the way, copies of the panel's report and can provide additional copies if they would so desire.

The panel concluded that preferred rates of postage continue to be vital to the survival of many nonprofit organizations. Indeed, it concluded that they have become more important than ever because of reductions in governmental social spending and expectations that the nonprofit sector will therefore increase its participation in the funding or providing social programs. That conclusion was reenforced last year by the Honorable Thaddeus Dulski, former chairman of the House Post Office and Civil Service Committee in testimony he presented before the House Appropriations Committee last year. Mr. Dulski was the chairman of the committee at the time of the Postal Reorganization Act.

But efforts to reduce the Federal deficit again threaten the revenue foregone appropriation. Now, more than ever, the nonprofit sector needs Congress to reaffirm its support for its works. Consider just a few examples: the country's oldest voluntary health agency, the American Lung Association raises 84 percent of the funding for its programs and services provided by its 150 constituent and affiliated associations through direct mail.

State of the art techniques are used to constantly improve the management and efficiency of these programs so as to maximize the return in order to support the Association's wide-ranging programs and services. These include funding biomedical research, operating smoking cessation programs and many other activities.

The March of Dimes Birth Defects Foundation relies heavily on direct mail funding appeals by mailing approximately 120 million pieces of mail per year. If the revenue foregone appropriate were to disappear and no other system were created to sustain reduced rates, the March of Dimes would find itself saddled with millions of dollars in added costs. The services that it provides to people and the research funds which it provides, as well as its educational programs would obviously suffer.

I can go on and give additional examples that would effect virtually all of the members of the Alliance of Nonprofit Mailers and all of the other nonprofit organizations that use the mails.

Senator Abdnor. Mr. Thomas, you're right. I know St. Joe's real well, I have been there a number of times and I just had a note that they testified in Minneapolis in front of Mr. Steiger and a group. I don't mean to be rude but you have a long statement and I want you to get the stuff in you want to but we're going to have to move along. So, if you could highlight your statement.

Incidentally, I think Mr. Parkinson has told you that the entire statement will be made a part of the record for us.

Mr. THOMAS. Yes, sir. I did not intend to read that portion of the statement that is the testimony that was provided by Dr. John Holiday.

Senator ABDNOR. You go right ahead. We won't count this time against you.

Mr. THOMAS. In the President's State of the Union Address, this year, he praised the mighty river of good works that contributed $74 billion, in voluntary giving, last year alone. Consider that the revenue foregone payment was reduced to only $716 million last year, The connection between nonprofit mailings and volunteer giving is too elementary for me to have to explain. I believe the return on the Government's investment is one of the best anywhere in the budget.

Since December, nonprofit postal rates for third-class mail has soared from 45 to 68 percent, depending on the presort category. We have abandoned the worthy plans of the Postal Reorganization Act that called for preferred rate mailers to pay no more than their attributable costs. Any efforts by nonprofits to plan for the future by budgeting for operating expenses have been thwarted by nightmarish postal increases. Again, nonprofits that so vitally contribute to our society now depend vitally on your reaffirmation of support for their activities.

If Congress believes that substantial savings in revenue foregone can help to balance the budget, as some suggest, the alliance is prepared to to assist. Our testimony to the Postal Rate Commission on March 12 offers three new innovative and effective methods for computing the subsidy. Each of these methods offer substantial savings to the taxpayer. I have included that testimony by Dr. John Haldi, our economic consultant, as part of the record.

But, I also note that the Commission's report and recommendation is not due until June and the subcommittee must report before that time.

Mr. Chairman. the members of the Alliance of Nonprofit Mailers firmly believe that the welfare of the American people is well served by the revenue foregone appropriation. We believe that the $833 million needed to fully fund the fiscal 1987 revenue foregone appropriation constitutes a wise investment in behalf of our entire society and we urge that it be included in full in this budget. Thank you very much.

PREPARED STATEMENT

Senator ABDNOR. Thank you, Mr. Thomas. I hope you don't think I was trying to rush you too much. I thought maybe you were going through the full length and I wanted to make sure you got the points that you wanted.

Mr. THOMAS. Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF JOEL THOMAS

Mr. Chairman and Members of the Committee, I am Joel Thomas, President of the Alliance of Nonprofit Mailers. I appreciate the opportunity to speak with you today on behalf of the 81 member organizations of the Alliance, which represent over 43 million members and volunteers in 86,000 chapters and affiliated organizations. Each of these members look to the decisions that you will make in this committee with profound interest and concern.

As we all know, this country is embarking upon a fresh effort to curb a federal deficit that has grown to unprecedented proportions. Yet we also strive to provide necessities to those that require assistance. For those of you in Congress, it is a difficult task to determine the appropriate balance between governmental cost and public gain.

The Administration has suggested that we should place more reliance on the good works of private sector intiatives to achieve our social and humanitarian goals. The White House Office of Private Sector Initiatives is the focal point for the Administration's efforts to promote private sector activity.

Our member organizations and other nonprofit entities have played a vital role in relieving government of burdens it otherwise would carry. They supply a considerable share of the social services, health care, education, research, arts, culture, community improvement, and public advocacy which our nation enjoys.

The millions of Americans who find in the organizations represented by the Alliance the means of channelling their volunteer spirit into action, agree with the President, who said:

> "The American people are deeply proud of this long tradition of neighbor reaching out to neighbor with a helpful hand. In the continuing need to solve community problems, the compassionate actions of the private sector reflect the sense of essential decency and concern that has so often been a hallmark of our national character. Truly, there is no finer expression of the values we cherish than our united efforts to address problems through the creativity and initiative of the private sector."

The majority of people find organization necessary to guide and direct their volunteer impulse. A strong organization is built upon effective communications. It is vital that members and volunteers are kept informed so that private contributions can be channelled to necessary avenues of need and efforts to achieve worthy goals effectively realized.

Congress recognized the importance of effective communication by charities as early as 1952 and further sought to foster and nurture the volunteer impulse in 1970 when the Postal Reorganization Act was passed. The Revenue Forgone payment to the Postal Service, built into the act, leverages greater efforts in behalf of the society by private sector nonprofit institutions, their members and volunteers. In 1970, participation by nonprofits was important to the health of society -- in 1986, the work of these groups has become imperative.

In June of 1984, because the longstanding national policy of providing low postal rates to nonprofit organizations had come into jeopardy, the Alliance established the Preferred Rate Study Panel to examine the status of preferred postal rates. That panel consisted of the Honorable Gale McGee, former Chairman of the Senate Post Office and Civil Service Committee and a prime sponsor of the Postal Reorganization Act of 1970; Mr. Cyril F. Brickfield, executive director of the American Association of Retired Persons; the Honorable J. Edward Day, former Postmaster General of the United States; the Honorable James M. Hanley, former Chairman of the House Post Office and Civil Service Committee, and the Reverend Richard Knuge, S.M., then president of the National Catholic Development Conference.

The panel concluded that preferred rates of postage continue to be vital to the survival of many nonprofit organizations. Indeed, it concluded that they have become more important than ever because of reductions in government social spending and expectations that the nonprofit sector therefore will increase its participation in funding or providing social programs. That conclusion was reenforced last year by the Honorable Thaddeus J. Dulski, former Chairman of the House Post Office and Civil Service Committee, in testimony presented before you.

But developments have led to a renewed attack on preferred rates of postage, an attack that threatens the life blood of the volunteer spirit. Now, more than ever, we need Congress to reaffirm support for the works of the private sector. Without such support, religious, philanthropic, educational, scientific, cultural, fraternal, veterans and labor groups will be forced into making hard decisions that can only decrease private sector activity.

Consider just a few examples: the country's oldest voluntary health agency -- the American Lung Association -- raises 84 percent of the funding for the programs and services of its 150 constituent and affiliated associations through direct mail programs. State-of-the art techniques are used to constantly improve the management and efficiency of these programs so as to maximize the return in order to support ALA's wide-ranging programs and services. Those include funding bio-medical research, operating smoking cessation programs and many others.

The March of Dimes of Birth Defects Foundation relies heavily on direct mail funding appeals, mailing about 120 million pieces a year. If the revenue forgone appropriation were to disappear and no other system were created to sustain reduced rates, the March of Dimes would find itself saddled with millions of dollars in added costs. The services it provides to people in need, the research it funds, and the educational programs it maintains would obviously suffer.

In South Dakota, a good example of the problems exacerbated by increasing nonprofit postal rates is the one of St. Joseph's Indian School at Camberlain. I think, Mr. Chairman, that you are familiar with this institution, which has been a haven for needy and unfortunately, all-too-often neglected, youngsters of the Sioux nation since 1927. But St. Joseph's, I understand, does more. It runs a shelter for women, as well. It also helps to market crafts produced by the local Indian population.

The school, as you know Mr. Chairman, is entirely dependent upon private donations, which means mail solicitation. I believe it receives no government funding, either federal or state.

The Salvation Army estimates its 11,000 local units in the U.S. send out 50 million pieces of third-class mail for charitable appeals in order to support its huge humanitarian effort. It's chapters are financially self-supporting and largely dependent upon direct mail.

The American National Red Cross, faced with a rash of natural disasters in 1985, spent a record $48 million in six months and ended up $14 million in the red as a result. So it has had to redouble its efforts to raise funds necessary if it is to be ready when needed again, as it surely will be. The Red Cross has turned to direct mail to raise funds and to bolster the donor base for its reserve disaster fund.

Those are just a few examples that unequivocally demonstrate that the postal accommodation of reduced rates continues to assist and, in some cases, ensure the worthy social and humanitarian goals it was established to foster. In addition, of course, other organizations find it possible -- because of preferred rates -- to disseminate essential information that furthers man's understanding of the world and universe we live in and to communicate with large numbers of people on important and complex issues.

In the President's State of the Union Address this year, he praised the "mighty river of good works" that contributed $74 billion in voluntary giving last year alone. Consider that the revenue forgone payment was reduced to only $716 million last year. The connection between nonprofit mailings and volunteer giving is too elementary for me to have to explain it to you. I believe the return of the government's investment is about the best you'll find anywhere in the budget.

Mr. Chairman, since December, nonprofit postal rates for third-class mailers have soared -- from 45 to 68 percent, depending on the presort category. We have abandoned the worthy plans of the Postal Reorganization Act that called for preferred mailers to pay no more than the attributable costs of handling their mail. Any efforts by nonprofits to plan for the future by budgeting for operating expenses have been thwarted by these nightmarish postal increases. Again, nonprofits that so vitally contribute to our society now depend so vitally on your reaffirmation of support.

The deficit must be reduced. If Congress sincerely believes that substantial savings in revenue forgone can help balance the budget, as some suggest, then the Alliance is prepared to assist you in every way possible. Our testimony to the Postal Rate Commission on March 12 offers three new, innovative and effective methods of computing the subsidy. Each of these methods offer substantial savings to the taxpayer. I include that testimony from our economic consultant, Dr. John Haldi, as part of this record. But I also note that the Commission's report and recommendation is not due until June and that this subcommittee and the entire Congress must appropriate funds now under current law.

If you think that reducing eligibility for preferred rate mailers will reduce the subsidy, then we are prepared to assist you in that regard, too. There are already comprehensive restrictions on the books that address eligibility. If these were more effectively enforced, savings would be realized.

Mr. Chairman, the Alliance of Nonprofit Mailers was formed by a group of organizations that recognize the urgency and the importance of private sector activity in providing for the welfare of our citizenry. We firmly believe that the welfare of the American people is well served by the revenue forgone provisions of the Postal Reorganization Act. We believe that the $833 million needed to fund the program for FY 1987 -- and that includes $58 million in a prior year adjustment -- constitutes a wise investment in behalf of our entire society. We also know that nonprofit America, having already incurred two postal rate increases in 1986 cannot afford yet another.

So, Mr. Chairman, we ask your continued support of revenue forgone.

BEFORE THE POSTAL RATE COMMISSION

PREFERRED RATE STUDY Docket No. SS86-1

COMMENTS OF DR. JOHN HALDI ON BEHALF OF THE ALLIANCE OF NONPROFIT MAILERS

I appreciate this opprotunity to discuss with you some issues concerning the revenue forgone appropriation for the preferred-rate subclasses of mail. My testimony today has three primary purposes. They are:

- First, to explain the hidden subsidy in the revenue forgone appropriation;
- Second, to examine the secondary benefits that accrue from the revenue forgone appropriation; and
- Third, to suggest some alternative methods by which revenue forgone might be computed, along with a framework for evaluating the advantages and disadvantages of each alternative.

Hidden Subsidy
Within the Revenue Forgone Appropriation

Ever since the Postal Reorganization Act became effective, the Postal Service has received each year a revenue forgone appropriation. At its inception, revenue forgone had two components: (1) a phasing appropriation, which was to cover the gradual phasing in of preferred rates until those rates were equal to full attributable cost; and (2) a continuing appropriation, to pay the difference between the revenue the Postal Service would have received but for the free or reduced-rate service required by the Act, and the revenues which the Postal Service actually receives from mail pieces carried at such reduced rates, or without charge in the case of free mail.[1]

Effective January 1, 1986, rates for all preferred subclasses of mail were raised to full attributable cost, except for free mail. This marked the end of the phasing appropriation. Except for free mail, the preferred subclasses of mail will henceforth pay their full attributable costs. In the future, revenue forgone will represent only the continuing appropriation.

In Docket No. R84-1 I previously discussed the revenue forgone appropriation before this Commission. There I pointed out that the Postal Service receives a contribution to fixed overhead from third-class nonprofit bulk mail which, as a percentage of cost, materially exceeds the contribution made by regular bulk mail.[2] This arises from the way in which the revenue forgone appropriation is computed.

In my prior testimony, I characterized as a "hidden subsidy" to the Postal Service that portion of the contribution to overhead considered to be extra generous. It appears that a similar situation also obtains with respect to the other preferred-rate subclasses. For fiscal 1985, it has been estimated that for all preferred-rate subclasses this hidden subsidy to Postal Service overhead amounts to some $272.2 million.[3] An estimate of the hidden subsidy in prior years is not available. Since 1970, however, the cumulative amount of this hidden subsidy doubtless amounts to billions of dollars.

On the basis of my involvement with postal matters, it would appear that some otherwise knowledgeable people do not appreciate how profitable the preferred-rate subclasses of mail have been to the Postal Service. Failure to recognize or acknowledge the generous contribution to overhead made by reduced-rate mail can lead to improper inferences, which will be addressed shortly.

For the record, let me explain here, in clear and simple terms, why the revenue forgone appropriation makes such a generous contribution to Postal Service overhead.

Succinctly, it costs the Postal Service considerably less to handle an average piece of reduced rate mail than an average piece of regular rate mail.[4] This lower unit cost of reduced-rate mail is key to understanding the hidden subsidy. Because revenue forgone is computed without any reference to the cost of handling the preferred classes of mail, the Postal Service receives full, regular rates for a lower-cost product.

Incidentally, not only does reduced-rate mail have a lower unit cost, in certain instances it receives even worse service than the corresponding class of regular rate mail.[5] So, for handling a lower-cost, inferior product the Postal Service receives a higher markup, or "profit margin" than on other mail. The net result is an extra generous contribution to its overhead. When the revenue forgone appropriation is taken into account, it becomes abundantly clear that the present system actually discriminates against the preferred-rate subclasses by penalizing them with a higher markup.

To sum up, thanks to the revenue forgone appropriation, preferred-rate mail has made a substantial and disproportionate contribution to Postal Service overhead.

Secondary Benefits from Revenue Forgone

From what I read, it would appear that many people, including some who should know better, believe that preferred-rate users are the sole beneficiaries of the revenue forgone appropriation. Such beliefs are fundamentally wrong, in my opinion. Let me explain.

First, the Postal Service unquestionably receives an extraordinarily generous contribution to overhead for handling reduced-rate mail. This was addressed in the preceding portion of my testimony.

Second, the Postal Service has never given preferred-rate users a free ride, or any other special consideration -- despite subtle inferences or nuances to the contrary. The Postal Service does not provide the revenue forgone appropriation; it receives it. Reduced-rate mailers owe no special thanks to the Postal Service for the revenue forgone appropriation. Any shortfall in revenue forgone triggers an almost immediate increase in preferred rates by the Governors of the Postal Service.

Third, the Postal Service is not a profit-making organization. So, what does the Postal Service do with the rather substantial hidden subsidy it receives from preferred-rate mail via the revenue forgone appropriation? The hidden subsidy is used to reduce the fixed overhead costs that must otherwise be distributed among regular rate mailers. In effect, regular rate mailers benefit from the billions of dollars of Postal Service overhead which reduced-rate mail has helped to defray.[6]

Finally, the U. S. Postal Service takes pride in pointing out that the minimum rate for a First Class letter, now 22 cents, is less than the minimum rate in other developed countries.[7] I accept their international comparison of First Class rates. But the favorable comparison with other countries does not arise because the Postal Service is a paragon of efficiency and increased productivity.[8] Rather, it arises from the huge contribution to overhead which the Postal Service receives from other classes of mail, including the preferred-rate subclasses. If First Class mail had to pay all or most of the fixed overhead of the Postal Service, then First Class rates would likely have to be raised to the levels of other developed countries.

Alternative Methods for Computing Revenue Forgone

It is possible to conceive of a number of different ways by which revenue forgone might be computed. This portion of my testimony will suggest three alternative methods for computing revenue forgone. For purposes of this testimony, I will refer to these three methods as:

1. The equal markup method;
2. The reduced markup method; and
3. The discounted rate method.

For ease of exposition, I will first describe how revenue forgone would be defined and computed under each of these alternative methods. Following this description, I will suggest a framework for evaluating the relative merits of the different methods. It will be seen that any one of these alternative methods would materially reduce the amount of the appropriation required to fund fully revenue forgone.

The Equal Markup Method

In the equal markup method, computation of revenue forgone takes as its starting point the cost of handling preferred-rate mail. Computation of revenue forgone would no longer be based on the rates charged for corresponding classes of regular rate mail. Revenue forgone would be computed using the same percentage markup, or coverage factor, that is used to develop corresponding regular rates.

Under the equal markup method, the Postal Service would receive the same percentage markup over attributable cost for preferred-rate mail as it receives for the corresponding class of regular rate mail. In other words, the percentage markup for preferred-rate users would be on an equal footing with regular rate mailers. The extra-high markups now implicit in preferred-rates would be eliminated.

The equal markup method of computing revenue forgone provides a minimum benchmark for possible reductions in the amount needed for revenue forgone. It has been estimated that use of the qual markup method in fiscal 1985 would have reduced the amount required for revenue forgone appropriation by $272.2 million. Under the other alternative methods, which I will now describe, even greater savings to the taxpayer are possible.

The Reduced Markup Method

The markup for preferred-rate mail does not necessarily have to achieve exact parity with the markup used for corresponding classes of regular rate mail. Instead, it is entirely feasible for the markup to be determined in a way that would give special consideration to preferred-rate users. For example, computation of revenue forgone for every preferred-rate subclass could be based on the lowest coverage factor paid by any class of regular rate mail. Historically, regular rate second and fourth-class mail have enjoyed rather low markups. This particular method of computing revenue forgone would extend the Postal Service's lowest commercial markup to all preferred-rate mail, in recognition of the extensive social benefits conferred by those organizations that send preferred-rate mail.

Alternatively, Congress may desire to retain some relationship between preferred-rate subclasses and corresponding classes of regular rate mail. This could easily be accomplished under the basic approach described here. Revenue forgone could be computed on the basis of (1) the attributable cost of each preferred-rate subclass, plus (2) a markup equal to some predetermined fraction of the markup used for the corresponding class of regular rate mail. For example, revenue forgone could be computed for each preferred-rate subclass using a markup that is equal, say, to one-third or one-half of the markup used for the corresponding class of regular rate mail.[9] Providing a lower markup for preferred-rate mailers would be another way to recognize the social contributions made by these organizations.

The Discounted Rate Method

The two preceding methods of calculating revenue forgone are based on an explicit markup over attributable cost. It is also possible to devise alternative ways of computing revenue forgone without reference to an explicit markup over attributable cost. It is only necessary to establish a "reference rate." This approach is essentially a variation on the present method used to compute revenue forgone. The present method uses as a reference rate the full rate paid by each corresponding class of regular rate mail.

For purposes of computing revenue forgone, the reference rate does not need to be the full rate. The reference rate could just as easily be established by using a standard discount from full rates. To illustrate, revenue forgone could be computed as the difference between (1) what preferred-rate users actually pay, and (2) the corresponding regular rate less, say, a 20 or 25 percent discount. Discounts are widespread in the business world, especially those that sell services. Some airlines, for example, have a 10 percent discount for senior citizens, as well as a variety of discounts for other users. Similarly, hotels and car rental agencies typically have a variety of discounts available for different users.

Under the discounted rate method, users of all preferred-rate categories except free mail would continue to pay their full atrributable cost. Revenue forgone would be the difference between the reference rate and attributable cost, times the applicable volume. If the reference rate, or the discounted full rate, happened to be less than full attributable cost for any of the preferred-rate subclasses, then no revenue forgone would need to be paid for that particular subclass -- except, of course, for free mail, where revenue forgone must also cover attributable cost.

Relative Merits of Alternative Methods

For the past several years, the current administration's budget has proposed to eliminate the revenue forgone appropriation. Congress has to date resisted these budget proposals, and it may well continue to do so. Nevertheless, it seems to me that any forward-looking analysis of alternative methods for computing revenue forgone needs to anticipate the consequences both (1) if Congress appropriates revenue forgone, or (2) if Congress fails to appropriate revenue forgone.

In the event of a failure of appropriations, the law could stipulate that rates charged to preferred-rates users would increase to the level implicit in whatever formula is used to calculate revenue forgone. Let me hasten to point out, though, that the law need not necessarily be written this way. The law might explicitly provide otherwise.

For instance, in the event Congress should fail to appropriate revenue forgone, the law might stipulate that (1) preferred rates would not rise above full attributable cost, or (2) preferred rates would increase by no more than a fixed percentage, or (3) preferred rates would be set in some predetermined way vis-a-vis corresponding regular rates. To illustrate this last possibility, the markup on preferred-rate classes might be set at some predetermined fraction of the markup used to establish rates for regular rate mail. Let us now examine the relative merits of these alternative ways of computing revenue forgone.

One basic criterion for evaluating the above-described alternative methods concerns ease of implementation. In my opinion, each of these alternative methods is easy to understand and easy to compute. Implementation of any one of them should be straightforward. They all appear to meet this basic criterion.

A second possible criterion is the extent to which an alternative method will reduce the amount needed to fund revenue forgone; i.e., the savings to taxpayers. Depending on the method and the particulars that are adopted, the amount needed for revenue forgone can be reduced to any desired level. At current mail volumes, the equal markup methods would save taxpayers just over a quarter billion dollars. The other two methods would save taxpayers even more.

A third way to evaluate these alternatives is to view them solely from the perspective of Postal Service revenues and the contribution which preferred-rate mail makes to the Postal Service's fixed overhead. Viewed from this somewhat narrow perspective, the Postal Service would presumably want the highest appropriation it can obtain, assuming that Congress is willing to appropriate the money each year. Suppose there should be a failure of appropriations, however. Then from the perspective of maximizing the contribution to Postal Service overhead, the best alternative would be that which most closely approximates Ramsey pricing.

An analysis of Ramsey pricing as it pertains to preferred-rate mail would involve a lengthy digression on the long-run elasticity of demand by preferred-rate users. Such a digression is beyond the scope of this testimony. However, should the rates actually paid by preferred-rate users approach the level of rates paid by regular rate mailers, I would then opine that the long-run elasticity of demand would become farily high. If my surmise is correct, then from the perspective of maximizing the contribution to Postal Service overhead, enlightened self-interest would indicate that revenue forgone should be computed by a method which requires an appropriation lower than that which would result from the equal markup methods.

Yet another way to evaluate these alternative methods is to consider them in light of (1) the criteria specified in Section 3622(b) of the Postal Reorganization Act, (2) the legislative history of reduced-rate mail, and (3) the wide variety of laudatory social purposes served by organizations that use reduced-rate mail, especially as they make a direct contribution to fulfillment of public policy objectives. Section 3622(b) spells out the criteria which Congress wants considered in postal rate setting. Based on the different criteria contained in Section 3622(b), it would appear that Congress does not want rates for all classes of mail set at levels which maximize the contribution to Postal Service overhead. Congress made special provision for preferred-rate users long before the Postal Reorganization Act became law. Since 1970, Congress has consistently supported reduced-rate users. Moreover, in light of the extensive contribution which preferred-rate organizations make to broad public policy objectives, I would suggest that social efficiency is best served by having preferred mailers continue to pay rates which just equal the marginal cost of handling their mail.

In light of the above consideration, I suggest that this Commission recommend to Congress that it adopt either the reduced markup method or the discounted rate method for computing revenue forgone. These two methods are fully consistent with past Congressional support for preferred-rate mailers. Furthermore, they also make a greater contribution to reduction of the budget deficit. If either of these two methods were used to compute revenue forgone, the amount needed could readily be reduced by anywhere from $400 to as much as $600 million below the current level.

Footnotes

[1] Postal Rate Commission, Docket No. R80-1, Opinion and Recommended Decision (February 19, 1981), Vol. 2, Appendix I, p.1. Note that computation of the continuing appropriation allows the Postal Service to presume, or have the benefit of the doubt, that it "would have received" the same volume and revenue if free or reduced rate service were eliminated and all such mail had to pay the full regular rate. This presumption is questionable; i.e., elimination of reduced rate mail would almost surely result in some diminution of volume and revenue, and there could be a sharp diminution. In economic terms, computation of the continuing appropriation treats the demand for reduced-rate mail as totally inelastic, at least up to the level of rates charged for regular rate mail.

[2] Docket No. R84-1, Direct Testimony of John Haldi on behalf of the Alliance of Nonprofit Mailers, ANM-T-2, pp. 2-11.

[3] The extra generous contribution to overhead by the preferred-rate subclasses would be eliminated by a rate structure that accurately and fully reflected cost-causing phenomena such as weight and shape. In prior dockets before this Commission I have consistently supported efforts to develop rate structures that would reflect cost-causation more accurately. Perhaps some day, in the near or distant future, more accurate cost-based rate structures will come into being. In the meantime, the extra generous contribution to overhead which is now buried in the revenue forgone appropriation can be reduced significantly by adopting alternative methods of computing revenue forgone, as described in the last section of this testimony.

[4] The lower unit cost of reduced rate mail has been a persistent phenomenon over the years.

[5] See Bulk Business Mail, Executive Brief (December, 1985) an Audit Report by the Postal Inspection Service. According to this audit report (p. 10), in a test of bulk mail letters, 59 percent of carrier presort mailings met service standards, while only 17 percent of the 5-digit and all other presort categories met service standards. The 5-digit and all other presort categories constitute a much higher proportion of nonprofit bulk mail than they do for bulk regular rate (BRR) mail. Thus, on average, non-rofit bulk mail receives significantly worse service than does BRR mail. Moreover, many BRR mailers also request and receive delivery on specific dates for a particular mailing. With regard to specific day requests the Postal Inspection Audit Report states the "(p)lant capacity and delivery constraints often necessitate that other (bulk) mailings be set aside to give these mailing preferential treatment." (p.9.) To the best of my knowledge, nonprofit bulk mailers never request delivery on specific dates, whereas the practice is fairly common among BRR mailers. Thus nonprofit mailers suffer disproportionately from the delays occasioned by the practice of catering to specific day requests without

ever profiting from the practice, as do many BRR mailers. On net balance, nonprofit mailers receive inferior service.

[6] It is clear that the Postal Service receives a very generous contribution to its overhead out of the total revenue which it receives for handling preferred-rate mail. It would be incorrect, however, to say that preferred-rate mail "cross-subsidizes" any class of regular rate mail. By the same token, if regular rate mail had to contribute a higher proportion of total Postal Service fixed overhead, and preferred-rate mail a lower proportion, it would be equally incorrect to say that preferred-rate mail was being cross-subsidized. So long as each class of mail pays its own attributable costs, there is no cross-subsidy.

[7] See U. S. Postal Service, Comprehensive Statement on Postal Operations, 1985, p. 31, Table 7.

[8] In the thirteen year period 1971-84, USPS Total Factor Productivity increased only 6.3 percent, which is an annual increase in factor productivity of only 0.5 percent. See Comprehensive Statement on Postal Operations, 1985, p. 43, Table 16.

[9] The amount needed for revenue forgone would consist of the markup over cost for all preferred-rate subclasses, plus the attributable cost of free mail.

Senator ABDNOR. I see that you all pretty much have the same concerns on the revenue foregone as does the committee. We've been battling this ever since I've been on the committee and up until now we've been robbing Peter to pay Paul. I mean, you know, we have to live with this budget, not Gramm-Rudman to start with, but the budget and maybe you can recall the problem we had last year.

But, my point is that we're starting from zero in this thing or we were, but the Budget Committees defeated the original budget sent up by the President. The Budget Committee of the Senate has included $716 million and if I were to be perfectly frank with you, if we can hold on to that it would be quite a victory.

So, a lot of things are still in the making and it's hard to see, but this committee, with what we have to go on, is pretty limited. We're still paying the price they put the Domenici budget in. We've got some items like Customs that fights drugs. I think that happens to be one of the very most important programs. Over at Defense, we've been beefing up that new equipment for Customs so they can carry on and fight to keep drugs out of here and their budget has been mutilated in the past and 1986 is not going to be much of a help either. So, we do have a lot of problems and I know what happens to small newspapers. I come from a town of 370. Maybe that tells you something. The guy told me more than once, my paper would go down the tube if something isn't done about revenue foregone. The man to my right, his father is in the newspaper business and not in the biggest town in the country either. I guess his might be 700 population, so we do know everyone's problems and we're very concerned and assure you I'll do everything I can.

PREPARED STATEMENT OF THE AMERICAN LEGION

I have a statement from the American Legion that I am going to—on the subsidy question and I am going to ask unanimous consent that it be included, at this point, in the record.

[The statement follows:]

Statement of Joseph E. Miller, Assistant Director, National Legislative Commission, the American Legion

Mr. Chairman and distinguished members of the Senate Appropritations Subcommittee on Treasury, Postal Service and General Government. The American Legion appreciates the opportunity to present its views relative to the Revenue Foregone postal subsidy. This is the fourth time in as many years that we've appeared before this subcommittee on the subject of postal appropriations. During this time, because of your work, nonprofit organizations have enjoyed the longest period of stabilized postage rates since the signing of the 1970 "Postal Reorganization Act". This subcommittee's efforts to insure that those served by nonprofit organizations would not suffer unduly as a result of increased mail costs have, in large part, been successful. We recognize that this has been a difficult task to achieve in light of the Administration's continued efforts to delete funds for this account. Your successes deserve commendation. In particular, Mr. Chairman, we would like to extend our gratitude and thanks for the leadership you've demonstrated on this important issue.

Unfortunately, Gramm-Rudman and the escalation of other costs associated with handling preferred rate mail have resulted in postage costs that have increased more than 70 percent since the beginning of this year and preferred mail rates are now above step 16. These increases have eroded the cushion that nonprofit organizations built up during the period of postage rate stability. On top of this, the Administration's FY '87 budget request would end preferred rate mail except for the blind and the handicapped. Certainly, we understand the Administration's desire to reduce the federal deficit, but we do not think that deleting the postal subsidy is a well-reasoned or prudent move.

Last year, in the "FY '86 Reconciliation Act", the U.S. Postal Rate Commission was instructed to hold a series of hearings to determine who uses and who benefits from subsidized catagories of mail; the content and frequency of subsidized mailings; how eligibility might be limited to reduce advertising and promotional use of subsidized rates; how the scope or amount of postal subsidies could be curtailed; and, how mailing practices would be adjusted if no longer subsidized through preferred rates. Recently, The American Legion had the opportunity to appear before the Postal Rate Commission during its opening hearing and discuss the impact of increased postage costs on publications at all levels of Legion activity. In addition, we provided the PRC with our assessment of how to preserve rate stability while reducing the level of appropriations needed to subsidize preferred rate mail. We think that you will find our PRC testimony informative and ask that it be included as part of the official record of these proceedings. Additional Legion testimony will be presented during four of the PRC's field hearings.

As you know Mr. Chairman, there is a great discrepancy between the Administration's FY '87 budget request for the postal subsidy and the amount that the U.S.P.S. Board of Governors says that it needs to maintain rates at step 16. For FY '87, the Administration has requested just over $40 million which would be used to continue funding free and reduced rate mail for the blind and the handicapped. The Board of Governors, on the other hand, has announced that it will need $833 million to fund the Revenue Foregone account during the upcoming fiscal year. The Governors have also requested an additional $40 million as a reconciliation adjustment for prior-year shortfalls from handling free and reduced rate mail. In total, the Postal Service estimates that it will need $873.3 million to maintain step 16 rates during the next fiscal year.

It seems clear to us that the results of the PRC study are going to be crucial to the continued existence of preferred rate mail. We therefore encourage you to press the PRC for their answers to the report's questions at the earliest possible opportunity. There are several reasons why we feel that this report will be invaluable. First, it should provide a blueprint for reducing postal subsidy appropriations while maintaining the current level of assistance to Americans and communities in need. Second, the report should be able to tell us whether there are abusers of nonprofit mail as some suspect. Third and lastly, it seems equally clear that one of the results of Gramm-Rudman will be that this subcommittee is not going to have the funds available to subsidize preferred rate mail at the level of appropriations being requested by the Postal Service. Despite the drawbacks of Gramm-Rudman, the Legion feels that a reasonable subsidy level when combined with a public service standard will enable deserving preferred rate mailers to preserve their essential mail communications. By setting a public service standard that is measurable and quantifiable immediate reductions in outlays can be achieved because nonprofit organizations unwilling or unable to comply with the standard would lose their preferred rate mail privileges. This action would not affect their nonprofit status since their activities would still be in the public interest, but the more stringent requirement that an organization demonstrate and quantify its public service would insure that only those organizations truly deserving of federal support would receive assistance in the form of reduced postage costs.

Last year, as requested by you, Mr. Chairman, we provided this subcommittee with a copy of a legislative remedy that we felt would achieve both reductions in outlays and retain the nonprofit mailing privileges for organizations that can demonstrate and quantify their public service. Indeed, Mr. Chairman, the courts have already ruled that Congress has wide latitude to subsidize the activities of some groups while not subsidizing similar activities in other groups. This public service should also be a matter of public record. We would suggest that any organization that is unwilling to document its level of public service, be precluded from using subsidized mail.

We would like to make one final point. Some individuals and groups that have seen our legislative proposal have asked whether we would seek to revoke their tax exempt status because they could not document their public service. Mr. Chairman, nothing could be further from the truth. The American Legion has no position on the many types of nonprofit operations permitted by law. Indeed, the matter of tax exemption is a separate issue and substantially different than subsidized mail rates. However, it is the Legion's position that if taxpayers are to bear the expense of subsidizing the mail costs of certain organizations, then it is reasonable and proper to expect to receive a measureable benefit from the subsidies.

Mr. Chairman, that concludes our statement and we will be happy to respond to any questions that you may have.

STATEMENT OF DANIEL S. WHEELER, PUBLISHER/EDITOR-IN-CHIEF, THE AMERICAN LEGION MAGAZINE

Madam Chairman, and distinguished members of the Postal Rate Commission:

The American Legion would like to thank you for this opportunity to present our views on an issue we consider to be of national import. That issue centers on whether the Revenue Forgone postal subsidy should be continued and, if so, for the benefit of whom and at what level of funding.

Your recommendations to Congress regarding this will potentially affect not only the 870,000 tax-exempt organizations in the United States, of which The American Legion is a significant representative, but also the hundreds of thousands of American citizens who are beneficiaries of the services provided. Key to The American Legion continuing its public-service programs at current levels of participation and funding is its ability to afford to communicate with members via the United States Postal Service.

As we understand it, this Commission has been tasked with examining principal areas of Congressional concern regarding the continuation of Revenue Forgone and the extension of preferred rates to nonprofit mailers. The American Legion has been a grateful recipient of nonprofit mailing rates for many years. We believe our experience in this regard may well be pertinent to your deliberations, especially as it applies to the services we have been able to provide the nation as a result of what was considered a farsighted and cost-effective national postal policy.

We believe that once Congress has weighed the benefits derived from Revenue Forgone expenditures relative to what they cost taxpayers, it will agree with our position that a reasonable level of Revenue Forgone appropriations should be continued.

Two of the questions posed by this Commission -- "Who uses and who benefits from preferred mailing rates?" and "How can the scope or amount of postal subsidies be curtailed?" -- we believe are interrelated. In preparation to answering those questions, as well as others posed, we should like to provide pertinent information concerning how postal rate increases have affected The American Legion; the benefits realized as a result of Revenue Forgone; and the actions The American Legion has taken to curb our ever-increasing mailing expenses, while cooperating fully with the Postal Service.

At the time of passage of the Postal Reorganization Act of 1970, The American Legion Magazine, our national publication, was paying approximately $180,000 a year to mail 12 issues to each of our nearly 2.7 million members. In 1986, only 16 years later, we will pay $2,200,000 for the same service, despite Postal Service automation, utilization of presortation discounts, and a change to a lower class mailing permit.

Even when measured over the period of a decade and a half, that is an astonishing increase. Perhaps a portion of that increase can be rightly attributed to a beginning rate that was unrealistically depressed. We do not believe, however, that rates in recent years have been unrealistically depressed, and we are, therefore, at a loss to understand how our government can expect us to continue to absorb increases of the magnitude experienced in recent years.

For example, based on a pressrun of 2,690,000 copies, the cost of mailing a 60-page issue of The American Legion Magazine in January 1985 was $102,608. To mail the same sized issue to the same number of people in March 1986 will cost $175,067 -- an increase of 70 percent in just 14 months! Moreover, our postal bill in 1986, for the magazine alone, will be 87 percent higher than in 1984.

Our American Legion Auxiliary, which has a monthly magazine serving its 1 million members, is facing similar increases. And, already both The American Legion Magazine and The National News each pay in excess of 23 percent of their respective publication budgets in postal expense.

Madam Chairman, we submit that no publication, much less those of nonprofit organizations, can be expected to absorb such mammoth increases in such a short period without suffering fiscal trauma. And, in the absence of a continuation of Revenue Forgone, the end of these debilitating rate increases is not yet in sight.

Some have suggested that increased postal expenses can be passed along to our advertisers and subscribers. That is true, to some extent, when referring to for-profit publications; however, the advertising potential of for-profit publications is not available to either The American Legion Magazine or The National News. These are organizational publications used primarily for the dissemination of Legion-specific information and analysis of national public policy issues related to fulfillment of our mandates. Our memberships span the spectrum of incomes and interests, and do not readily lend themselves to the type of demographic and income targeting so prevalent in the advertising world today. Further, even at our current depressed advertising rates, we are encountering strong price resistance from our primary class of advertiser, the mail-order industry. Advertising linage itself has been declining for a decade.

That leaves only our primary source of income, subscription revenue, which is part of the dues structure of both The American Legion and its Auxiliary. This dues structure is not amended easily, and any modification must be approved by the duly elected delegates assembled in National Convention. Even if acted upon favorably by a National Convention, a time lag of 18 months will ensue before any increased monetary returns will be forthcoming to either national magazine.

When faced with such postal increases as we have experienced in recent years — in fact, twice in the past three months -- we have one alternative only: channel monies from program areas to pay current publishing expenses. Even when there is adequate time to budget for increases, our revenue sources are so restricted that the bulk of dollars to cover additional expenses must be diverted from our program areas.

The American Legion Magazine, of course, is not the only item mailed from our National Headquarters at preferred rates. Attached to this report is a sample of lesser circulation publications, as well as information concerning their circulation and frequency, as you requested. Additionally, dues renewal notices and other information items are periodically mailed to our membership. All told, we have experienced a 228 percent increase in postal expenses overall at the national level within the past 10 years.

But that reflects only a portion of the problem. The American Legion also has 58 departments (comprising the 50 states, District of Columbia, and seven foreign nations) and nearly 16,000 community-level posts, as well as 12,000 Auxiliary units nationwide. All have felt the impact of rising postal rates; many to the point that their newsletters and department newspapers have either cut back drastically or ceased publication. Such actions cripple communications at the community level, making it all the more imperative that publications such as The American Legion Magazine remain strong.

In an effort to survive spiraling postal rates, The American Legion Magazine has taken steps to help minimize damage and lessen financial constraints placed on other important Legion programs. Among actions taken are the following:

- In 1981, The American Legion enacted a per capita dues increase and allocated an additional $1 per member to the magazine, bringing that assessment to $2.50 per year, a 66 percent increase.
- The magazine cut the basis weight of an already lightweight cover stock from 70 pounds to 60 pounds, and the basis weight of body stock from 40 pounds to 35 pounds. This effected an annual postage savings of about 10 percent.
- In 1982, in the face of intolerable increases, the magazine gave up its second-class nonprofit permit in favor of a third-class nonprofit permit. This slowed delivery service somewhat, but curbed, at least temporarily, the effects of record rate increases. As a result of this action, The American Legion Magazine's foreign copies could no longer be entered into the Postal Service, requiring us to contract with a mail agent to provide this service at a cost of $87,000 in 1985, for delivery of 8,500 copies.
- The magazine makes full use of discounts allowed for presortation. Currently, about 64 percent of all issues are carrier-route qualified, and 20 percent are five-digit qualified.
- In order to ensure an accurate subscriber list, the magazine requests postal address corrections for each issue, a service that costs The American Legion about $100,000 per year.
- In 1986, the magazine will cut the number of pages published from 744 to 724, thereby saving about $50,000 in mailing expense, but losing 20 full pages of informational content important to the maintenance of voluntarism within the Legion.
- The magazine has complied with virtually every Postal Service request designed to expedite mail delivery and reduce USPS handling costs, even though our printing plant processing expenses have risen as a result.

Despite such economies, our magazine's total postal costs are still nearly double those of two years ago, and twelve times those of 16 years ago. You may argue that still this amounts to only cents per copy, and that is true. However, with 31,800,000 copies being mailed each year, an increase of "only cents per copy" is quite considerable, and that is money that must be subtracted from funding for ongoing programs, such as, in 1985 alone:

•Sending 30,000 young men to Boys State, at a cost of $2.1 million. •Sponsoring 2,600 Boy Scout troops, at a cost of $1 million. •Sponsoring 3,600 American Legion Baseball teams, at a cost approaching $10 million. •Sponsoring more than 10,000 youths in Oratorical Contests. •Awarding more than 3,700 scholarships. "Volunteering more than 2,000,000 hours to community service, and who can measure its value? •Donating more than 400,000 pints of blood. •Representing more than 350,000 veterans in rehabilitation cases, as well as donating more than $1 million in direct assistance. •Donating more than 1,000,000 volunteer hours at VA hospitals.

And we would be remiss if we failed to also note that the American Legion Auxiliary donated 6,500,000 volunteer hours, and raised and reinvested in America more than $26,500,000 in 1985 alone!

The benefits accruing to American society as a result of programs and activities such as these are incalculable, and probably far exceed the $64 billion value assigned to them by a 1981 Gallup survey.

What is equally significant is that, in large measure, these activities are made possible by our ability to communicate with our members at reasonable rates through the United States Postal Service. Most of this communication provides information of general membership interest about programs carried out at the community level, but coordinated at the state and national levels. These direct services to the public are worth far more than the meager cost of mail subsidies, and are precisely the sort of private-sector, self-help initiatives endorsed by the President when he spoke of increasing our national level of voluntarism.

It is a simple fact that people need to know where and when they are needed in order to respond. If citizens don't know where help is needed, in whatever form, they can't be expected to lend support. To effect this end, the significance of preferred mailing rates to certain nonprofit organizations is undeniable. Increased postal rates make it continually more difficult to keep community-based volunteer programs alive.

The appropriation of funds for Revenue Forgone represents one of the best uses of assistance by the government to ensure the free flow of ideas so essential to the prosperity of our republic. As Senator Barry Goldwater observed, and we agree: "The circulation of the printed word in the mails has historically been treated as a public service which should be promoted by the government....Any time the public is deprived of a broad range of sources of culture and information that it is now receiving, we cannot know what drastic changes may be set in motion."

All across this nation, hundreds of thousands of people, as well as thousands of communities, reap benefits as a result of a postal subsidy that represents a mere fraction of 1 percent of all federal expenditures. The cost-to-benefit ratio of the Revenue Forgone postal subsidy, dollar for dollar, makes it one of the soundest investments any government ever made toward the health, education and well-being of its citizens and communities.

Yet, there are critics of Revenue Forgone who would still argue that the cost of mail should be borne by the users of mail services. Such arguments sound reasonable enough, but they indicate a deficiency in understanding the difference between for-profit and nonprofit organizations, and confusion concerning ultimate beneficiaries.

The profit-making ventures seek corporate gain to be distributed among shareholders. Nonprofit organizations seek only the wherewithal to continue to serve those who are in need of the services they provide And, as a result of the efforts of organizations such as The American Legion, those beneficiaries are well served indeed.

Who can measure the cost to society if it were forced to pay for the services now provided by volunteers? The small number of dollars shared by society as a whole to fund Revenue Forgone benefits society as a whole, and is certainly far less than the resources that would be needed if such volunteers were not mobilized by organizations such as The American Legion.

Nonetheless, Congress is seeking ways to curb subsidies. Although The American Legion has complied with both the letter and the spirit of the law making it possible for us to enjoy nonprofit rates, we realize that the number of tax-exempt organizations continues to grow, and there is evidence that not all use the subsidized rates as Congress surely intended. Therefore, in order to curb the scope and amount of subsidies, we suggest that a standard of public service be established as a prerequisite to qualifying for preferred mailing rates.

If the taxpayers are to bear the expense of subsidies, it is only proper that they should benefit by the demonstration of a measurable service to our nation's communities by those who enjoy such subsidies. And this yardstick should be a matter of public record reported annually to a responsible arm of the federal government. The American Legion, for instance, discloses its balance sheet and a public record of all of its activities each year in its "Annual Report To The United States Congress." Other public-spirited organizations certainly would not object to following a similar procedure.

We suggest this general guideline as a starting point for legislation making measurable public benefit a prerequisite for a preferred rate mailing permit: "A user of nonprofit rates must be providing a measurable public benefit, in addition to the dissemination of general intelligence."

Obviously, some current nonprofit mailers would not meet this standard. We realize that their concern over a more stringent eligibility standard could create some discomfiture for Congressional members who would support a tightening of requirements. Political discomfort, however, is a rather constant companion of any member of Congress today who seeks to reduce the federal deficit.

To further tighten eligibility, we believe Congress should enact legislation that strictly prohibits the sale of any merchandise through the use of a nonprofit mailing permit if that merchandise is commercially available in essentially the same form. Fund-raising items that are valued at nominal cost would be exempted. This would permit nonprofit organizations to continue to raise funds for worthwhile purposes and to promote items embossed with their insignia, but would necessitate that those taking unfair advantage of their nonprofit status begin paying the postal costs rightly attributable to such enterprises.

We believe that these two actions alone would reduce the level of federal postal subsidies without any significant loss of public benefit.

This Commission has also been tasked with providing recommendations on: How might eligibility be limited to reduce advertising and promotional use of subsidized rates?

We realize that blatantly self-serving or improper use of nonprofit mailing permits not only damages the reputations and weakens the cases of legitimate nonprofit organizations, but that it also increases postal costs for all of us. Therefore, we would recommend that for-profit businesses be strictly prohibited from using nonprofit permits, under any pretense, for direct-mail advertising or promotion not directly related to the stated aims of the nonprofit organization performing the mailing. This, of course, would not apply to legitimate advertisers appearing in periodical publications of nonprofit organizations which meet all other criteria. It would eliminate, however, abuses such as occur when for-profit businesses team up with nonprofit organizations in joint ventures requiring the nonprofit organization to mail promotional material at nonprofit rates in return for a cut of the profits.

The last broad issue we wish to address is: How would mailing practices be adjusted if no longer subsidized through preferred rates?

The American Legion Magazine, other National Headquarters publications, and department and post publications would undoubtedly be forced to cut pages, frequency, or both. Many worthwhile publications now rendering a public service would be eliminated simply because it would be financially impossible to overcome the postal expense burden.

As a result of reduced communications, the finite amount of funds we now receive in membership dues would dwindle as membership decreased due to insufficient communication. As membership decreased, levels of community volunteer service would decline, and beneficiaries of all ages would suffer. The great works made possible by affordable postal rates would be diminished, and foolishly so inasmuch as Revenue Forgone is certainly one of the most cost-effective programs currently being funded by the United States Government.

The American Legion recognizes the deficit burden facing Congress, and we recognize its impact on the national economy. We, too, support fiscal responsibility, but we do not support balancing the budget by targeting the very individuals who are saving the government money. By that, we mean we don't support cutting off the lifeblood of American voluntarism -- communications.

It would be indeed tragic if in pursuing the worthy goal of self-sufficiency, the Postal Service brought on the unintended decline or demise of untold numbers of newsletters, newspapers, and periodicals now providing a measurable public benefit at a bargain price.

We are certain that this is not what Congress intends. This recognition has led nonprofit organizations providing a measurable public benefit, of which we are certainly a leader, to ask Congress not for a rollback of postal rates, but instead for stabilization. Continuation of Revenue Forgone will provide that.

We believe that this is certainly a reasonable and responsible request.

Madam Chairman, that concludes our statement. We would be happy to respond to any questions you may have.

Postal Reorganization Act Amendments of 1985

A Bill

To amend Title 39, United States Code, to provide for rate stability of non-profit and preferred rate classes of mail; to stabilize existing rates; to set forth guidelines for the equitable distribution of limited resources, and for other purposes.

This Act may be cited as the "Preferred Postage Rate Amendments Act of 1985".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, that the following provision of Title 39 U.S.C. are hereby amended:

SECTION 102

Section 102 is amended by adding the following subsections:

(4) public welfare has here the same meaning as found in Title 42;

(5) public assistance for the purposes of this title means;

(a) direct aid to beneficiaries; or

(b) volunteer community assistance; or

(c) service to beneficiaries through a recognized organization or sub-organizations providing training and or employment counseling; government benefitcounseling; non-profit and or low fee day care for senior citizens or children of working adults and; transportation services at minimal or at no cost for the handicapped, and or elderly.

Section 3626 (a) (1) is amended to read as follows: delete, "and indirect" following the word direct.

Section 3626 (a)(d) (1) is amended to read as follows: delete the period after livestock(.) and add "and which are not organized for profit".

Section 3626 (a) (d) (2) is amended to read as follows: delete the period after "pursuits." and add the following "and which are not organized for profit."

Section 3626 (a) (3) is amended to read as follows after the period ending "...at such rates":

Nor shall any organization be entitled to mail such matter at the rates provided under this section unless that organization meets such minimum requirements as may be developed by the United States Postal Service and the Department of the Treasury in order to insure that only those organizations contributing to the public welfare through direct forms of public assistance sufficient to offset the difference between the cost of mail matter at regular rates and the preferred rates then in effect. Subentities of non-profit and other preferred rate mailers shall be eligible to mail at the rate permitted the parent organization provided that such mailing not be used primarely to sell; offer for sale; or in any way dispose of merchandise or services available through commercial sources except that this provision shall not apply to advertisements inserted in periodical publications where all other requirements and provisions have been complied with. Nor shall any mailing by any preferred rate mailer be permitted which is intended to act as a sales vehicle of any kind offering for sale, to sell, or otherwise dispose of merchandise or services available through commercial sources, except that space in periodical publications of non-profit organization sold to for profit entities shall not be considered a prohibited activity under this or any other section.

PERMANENT RELATIONSHIP OF PREFERRED TO COMMERCIAL RATES

Sec. 3 Section 3626 of title 39, United States Code, is amended to read as follows:

A. the rate or rates of postage for each class of mail or kind of mailer under former sections 4358, 4452 (b) and (c), and 4554 (b) and (c) of this title shall be adjusted at the same time other rates are changed under this chapter. Such adjustments shall preserve the percentage relationships which each such rate for mail under such former sections bore as Septeber 1, 1984 to the respective comparable rate in effect under this chapter which would apply to such class or kind if this section did not apply. Such adjustment shall provide for rounding each rate adjusted under this subsection to the same decimal to which such respective comparabe rate is rounded.

SEC 3627 of title 39, United States Code is amended to read as follows:

Sec. 1 The Post Master General shall within six months (6 months) of the enactmentof this provision cause to have delivered to the Congress of the United States a detailed breakdown of assigned attributable and unassigned institutional costs for all classes preferred rate mail matter under former sections 4358, 4359, 4421, 4422, 4452, or 4454 of this title, as such rates existed on September 1, 1984 and shall likewise cause to be delivered to the Congress a breakdown of all assignable costs and their percentage of assignment to the variouse classes of mail matter described above in effect on September 1, 1984 and such previous years as may be designated elsewhere in this report including all formulas for making such determinations and such reports shall consist of charts, tables and other documentation as may be required to present the information in such a manner that the figures for each year shall be easily compared to the figures in the preceeding years 1979,1980 1981, 1982, 1983 if the assigned attributable costs, in any way differ from the attributable costs assigned on September 1, 1984, or if such change in attributable costs is anticipated in out years beyond September 1, 1984, be either the United State Postal Rate Commission or the United States Postal Service.

A. Upon receipt of the report Congress shall determine those costs which it shall deem attributable for the purposes of maintaining rate stability and in no case shall the Board of Governors of the United States Postal Service or the Postal Rate Commission include, for purposes of determining rates after such Congressional action, any costs not so found by the Congress to be attributable to the handling of preferred rate mail. When there is sufficient evidence to indicate that further costs should be assigned or that the percentage allocation in existence on September 1, 1983 should be altered the United States Postal Rate Commission shall deliver to the BOard of Governors of the United States Postal Servcie all such documentation for delivery to the Congress who shall have the exclusive right to determine whether such additional attributable costs or increases in percentage allocations of attributable costs shall be allowed, but in no way shall this amendment prohibit the United States Postal Rate Commission and or the Board of Governors of the United States Postal Service from reducing such percentage of attributable costs which may no longer have applicability to the rate or rates in question.

B. At no time without express Congressional approval shall the percentage differentation between the applicable Commercial rate and the coresponding preferred rate for those classes of mail set forth above exceed the percentage differentation in effect on September 1, 1984 so that at all times the difference in rates between commercial mail matter and preferred rate mail matter as described above shall remain constant.

NATIONAL HISTORICAL PUBLICATIONS AND RECORDS COMMISSION

Senator ABDNOR. Our witnesses, Miss Page Putnam Miller, director of the National Coordinating Committee for the Promotion of History and Miss Charlene Bickford of the Coalition to Save Our Documentary Heritage, will join us at panel and present testimony on behalf of their organizations with regard to funding for the National Historical Publications and Records Commission [NHPRC] Grant Program.

We welcome you both. Miss Miller, you go right ahead.

Ms. MILLER. Mr. Chairman, we have tried to sort of coordinate our testimony and I think it would be best if Charlene Bickford went first, if that is alright with you.

Senator ABDNOR. Very fine, you bet.

STATEMENT OF CHARLENE N. BICKFORD ON BEHALF OF THE COALITION TO SAVE OUR DOCUMENTARY HERITAGE

PREPARED STATEMENT

Ms. BICKFORD. Mr. Chairman, thank you for the opportunity to be here today. I would ask that the testimony of one of my colleagues, Edward Carter, who is the librarian at the American Philosophical Society in Philadelphia be included in the record. He testified yesterday before the House yesterday.

Senator ABDNOR. We will be very proud to make it a part of the record and without objection it will so be done.

[The statement follows:]

STATEMENT OF EDWARD C. CARTER, II, LIBRARIAN, AMERICAN PHILOSOPHICAL SOCIETY OF PHILADELPHIA

I am Edward C. Carter II the Editor in Chief of The Papers of Benjamin Henry Latrobe and Librarian of the American Philosophical Society of Philadelphia. I want to thank you for the opportunity to appear before this committee today. I am here to testify as the representative of the 56 member organizations of the Coalition to Save Our Documentary Heritage. These organizations represent historians, archivists, genealogists, educators, librarians, and editors who share a common belief that the preservation and publication of the source documents of the United States and its people will in no small measure strengthen American democracy now and in the future.

The members of the Coalition vigorously urge this committee to fund the grants program of the National Historical Publications and Records Commission (NHPRC) at the authorized level of $5 million. Congress mandated this funding level for FY '86 - '88 but it has yet to be achieved. A number of important and well-managed new editorial projects which have completed their "start-up" periods are demonstrating an unusually high level of publication productivity due to the adoption of modern computer technology. Curtailment in NHPRC funding thus threatens the achievements of editors and staffs who have already economized rigorously. This tiny and highly efficient program performs a real service at a very low cost for American historical scholarship and in due course the general public. The Coalition notes that Congress has continually exhibited its support for the mission of NHPRC and hopes that this committee will support the full authorized $5 million figure once again.

The major thrust of my testimony will be personal and somewhat idiosyncratic. I understand that the Coalition will provide members of this committee with a fact sheet detailing the nature and scope of NHPRC's remarkable achievements in the areas of book and microform publication and records preservation. I will speak as an editor of fifteen years' experience who is now bringing to a conclusion, with extensive federal and private financial support, the edited works of this nation's first great professional architect and engineer--the man who built this beautiful, monumental home of the United States Congress--Benjamin Henry Latrobe.

I also am the Librarian of the oldest learned society in America that without federal funds has supported a number of our most significant modern historical documentary editing projects--the American Philosophical Society that was founded by Franklin in Philadelphia in 1743, and, except for the period of British occupation during the Revolutionary War has met there regularly since 1769 to promote useful knowledge in the United States and throughout the world. While I do not speak for the Society in these hearings, I want you to know that I live in both the worlds of federally and privately funded scholarship and I fully comprehend and appreciate the key leadership role that the United States government should and does play in documentary historical editing. The American Philosophical Society, which receives no public funds, has contributed financially to several editions--some $350,000 to _The Papers of Benjamin Franklin_, smaller amounts to _The Papers of William Penn_, _The Papers of Benajmin Henry Latrobe_, of William Thornton--first architect of the United States Capitol, of Joseph Henry, first Secretary of the Smithsonian Institution, of Charles Willson Peale, and of Charles Darwin. In addition, the Society has provided free of charge quarters, light and heat, and scholarly support for extended periods of time to the Darwin Papers and the Latrobe Papers projects.

Why should Congress press for the full level of authorized support for NHPRC? The basic point is that the Commission is the only federal agency dedicated solely to the financial and technical support of the preservation and publication of the sources of American historical documentary scholarship. The national nature of this field of intellectual endeavor requires that the federal government provide the necessary leadership. NHPRC has met this challenge brilliantly and in a most economic fashion. To purloin the famous words of Winston Churchill -- "Never have so few taxpayer dollars done so much for so many."

Specifically in what ways do I believe that NHPRC has fulfilled its mandate so as to merit your committee's continued legislative support and that of Congress as a whole?

THE PUBLICATION OF KEY DOCUMENTS OF AMERICA'S HISTORY. For half a century NHPRC has facilitated the collection, study, editing, and publication of the papers of those individuals and groups who shaped our nation's history. As we enter the Bicentennial of the United States Constitution it should be noted that our understanding of the process of establishing our federal framework of government has been enhanced greatly by the Commission's timely support of four germane projects: The Documentary History of the Ratification of the Constitution and The Bill of Rights, The Documentary History of the First Federal Elections, The Documentary History of the First Federal Congress, and The Documentary History of the Supreme Court (1789-1800), which were initiated by the NHPRC.

Previously NHPRC helped launch and continues to fund the great modern editions of our Founding Fathers: Franklin, Jefferson, Adams, Hamilton, and Madison. But the members of the Commission and its superb small staff long ago recognized that we have other Founding Fathers and Mothers whose words and deeds deserve preservation and publication so that they might be available to our college and high school students and other members of our citizenry. Thus NHPRC has encouraged the creation and funded numerous, varied editorial projects that highlight the achievement of our puralistic democratic process of nation building. Because of the farsighted and professional leadership of NHPRC we now have the papers of notable women, Blacks such as Frederick Douglass, other minority leaders and groups, Native Americans, artists, such as Latrobe and Charles Willson Peale, labor leaders such as Samuel Gompers, businessmen, scientists, the early archives of New Mexico (1621-1921), and many more worthwhile ventures. Indeed, it is a bountiful harvest that the commission is helping gather in as we enter the Constitution Bicentennial celebration.

EDUCATION AND TRAINING. NHPRC with the assistance of federal and private funds has played and continues to play a significant role in the creation of a new scholarly profession--the historical documentary editor. When I entered the field fifteen years ago, the first great modern editors--Julian Boyd of the Jefferson Papers and Lyman H. Butterfield of the Adams Papers--were nearing the end of their distinguished careers. I acquired much of my editorial skill through their generous *ad hoc* instruction, but clearly a more formal mechanism was required if new projects were to be competently staffed. NHPRC took the lead with a series of conferences on the needs and opportunities of editing. The Commission's greatest contribution has been its sponsorship of annual summer editing institutes at the universities of Virginia, South Carolina, and Wisconsin. NHPRC assisted in the funding of the Association for Documentary Editing. In short, NHPRC has helped create an entirely new scholarly professon.

PRESERVATION OF RECORDS. Besides the documentary editing program, NHPRC's other major task has been to encourage the care of vital archival materials throughout the nation. Here is a primarily state and local problem that is being addressed with the assistance of federal leadership. Since 1975 when the Records section of the Commission was established, NHPRC through grants and technical advice has assisted public agencies and private organizations, such as historical societies and universities, throughout the country to identify problems of documentary disorder and decay and to launch effective preservation programs.

A WISE AND BALANCED RECORD OF FUNDING DOCUMENTARY EDITIONS. This is an absolutely necessary function of NHPRC. My project, The Papers of Benjamin Henry Latrobe, which has received ten NHPRC editorial grants and seven publication subvention grants is unusual in that it has attracted wide support from private foundations and individuals (perhaps 25% of our total funding). While to some degree this reflects my ability as a persuasive fundraiser, it is due mainly to the fact that Latrobe's works are highly important, beautiful, and appealing to a wide audience of scholars and the general public. (I have taken the liberty of bringing two volumes for the Committee's inspection.) The point I wish to make is that without federal funds and the NHPRC's certification I would never have been able to secure the major private grants that I did from The Andrew W. Mellon Fundation, The Rockefeller Foundation, and the U. S. Capitol Historical Society. Most documentary historical projects do not have the general appeal of the Latrobe Papers nor do their editors have the time or requisite skills to secure major private support. NHPRC funding is the life blood of these projects--certainly during the start up years. The Commission's staff has been quite effective lately in helping editors tap private sources when volumes begin to emerge from University presses assisted by publication subventions.

THE HEALTH OF THE NATIONAL ARCHIVES ITSELF. NHPRC not only serves the American scholarly public but it is also highly important to its parent organization the National Archives and Records Administration. I base my judgment on a year long consideration of the strengths and needs of NARA. Until a week ago, I was a serious final candidate for the position of Archivist of the United States. Last Tuesday, the White House informed me that the President had selected another person for this most important post. During the course of my candidacy for the Archivist position, I spoke with a number of the leading NARA administrators, staff members, representatives of user groups, and had several interviews at the White House. Those conversations and much reading only reinforced my initial belief that NHPRC should be funded fully and also suggested that its present functions could be expanded with profit.

Today NHPRC is the major section of the National Archives that interacts on a regular formal basis with scholars, universities and historical societies, and academic presses. A term of service on the NHPRC staff would be beneficial for young administrators of promise throughout the service. Experience gained in NHPRC would be excellent training for establishing much needed contacts between regional NARA offices, Presidential Libraries and local academic history department, historical societies, and archives. This is the direction that the National Archives as a whole is moving and NHPRC will be a valuable facilitator of this policy.

I conclude by urging the committee to lend its support not only to NHPRC but also NARA in its entirety. The National Archives is facing many pressing problems in Washington and throughout the nation. The building on Pennsylvania Avenue needs to be redesigned and rebuilt so as to house its present collections more safely and efficiently and also to provide modern exhibition and meeting space. A promising and vitally needed preservation program has been planned and partially staffed but not initially funded even though budgeted. Perhaps the most pressing need of the National Archives is how to provide for current and future storage space. Clearly the problem can only be solved by the construction of a modern, technologically advanced Annex Building in the Washington area--preferably near or on the Mall. These are serious issues of national importance; let us address them in a logical and energetic way.

Mr. Chairman and members of the committee let me thank you again for giving me the opportunity of testifying before you. If you have any questions, I will be pleased to answer them.

Ms. Bickford. Thank you, Mr. Chairman.

We realize that the committee is between a rock and a hard place this year and, as you expressed earlier. And, I would remind you although that this grants program which was at the same funding level in 1981 that it is in 1986, has not really played any role in the increasing size of the Federal deficit in the last few years.

We are requesting that it be funded at the full authorized level this year because of the fact that it has remained steady for the last 6 years, it's really beginning to take it's toll on the program and one of the real up and coming problems is the fact that a coalition of five of the editorial projects, publishing the papers of the Founding Fathers, got a considerable amount of private funding from foundations back in about 1981, a 4- or 5-year period. It's pretty clear that they're not going to get this kind of money again. They got $1.5 million from Pugh Foundation and $1.5 million from Mellon. Mellon has already told them that they are probably not going to get the money again.

And, the projects are projects to which the NHPRC is committed, seeing it through to completion and they're going to be back in this year, I think, for substantially larger funds than what they have been receiving the last few years.

I think you have heard our arguments over and over again on this issue and they're probably a little worn.

But, I would like to quote to you from a letter that Thomas Jefferson wrote to Ebenezer Hazard who was one of the original documentary editors and Hazard had sent him a collection of American state papers that he had recently published and Jefferson says, in short, that he is satisfied that Hazard had started this project and he said:

> Time and accident are committing daily havoc on the originals deposited in our public offices. The late war has done the work of centuries in this business. The lost cannot be recovered, but let us save what remains, not by vaults and locks which fence them from the public eye and use, in consigning them to the waste of time, but by such a multiplication of copies, as shall place them beyond the reach of accident.

I like to think that Jefferson was really setting the policy for the NHPRC and it is interesting that Jefferson's papers were the first to be started under the Commission's egis.

The experience of this country is unique in the history of the world and I believe that the Federal Government has a responsibility to take part in the preservation of this American experience, as part of a partnership between the Federal Government, local and State governments, local historical socities, in the case of the project that I am associated with, the documentary history of the First Federal Congress. We're based at George Washington University. George Washington picks up our telephone costs, our office space, provides us with furniture because Commission grants do not provide any indirect costs, they're strictly for direct costs of the projects.

And, I would like to bring you up to date a little today on some of the progress of these projecs this past year.

This last summer, Members of the Congress gathered in the Rotunda of the Capitol to commemorate the centennial of the death of Ulysses

S. Grant and there was also a ceremony at the Grant statue at the base of Capitol Hill.

But, I think that the publication of two more volumes relating to the Civil War time period of Grant's papers is a much more lasting result than a simple commemoration of the type that went on, even though that was important.

In contrast to the Grant papers which let us look at history from the leadership standpoint, in the past year also, another volume of "Freedom," a documentary history of emancipation, 1861–67 which takes it from a bottom up approach and provides tremendous insight into the lives of blacks during the period during and after the Civil War has appeared.

Reviews of "Freedom" have hailed the two published volumes as revolutionary new sources. In the words of Ira Berlin, the editor and project director of "Freedom", "This is the fullest record that exists anywhere in the world of a people going from being slaves to being free."

Although the subject matter of these two series is very different, both projects serve to illuminate a picture or a period when the United States underwent the most threatening constitutional and social crisis in its history and both rely heavily on documentary records of the U.S. Government in the National Archives.

And, the last thing that I would like to highlight is the bicentennial of the United States which is occurring, in fact, the President's Bicentennial Commission was meeting the last 2 days up here on the Hill. There are a lot of proposals as to what to do to commemorate the bicentennial of the Constitution and the formation of our Federal Government, but I would think that the cries of celebration and the music of the marching bands that will go on would have a hollow ring to them if the project's publishing the definitive documentary histories of the ratification of the Constitution, the first Federal election, the first Federal Congress and the first 10 years of the Supreme Court of the United States are forced to severely curtail their work or close down altogether because there are no grant funds available from the NHPRC.

At the same time that this is being threatened in this area, there are proposals for more funding for the bicentennial around up here for nationwide essay contests for $4 million and this sort of thinq and I think that the Congress should think seriously about this kind of scholarship before funding new programs.

Those four projects I just named published a total of seven books in the past year, including three volumes of the histories of all of the legislation passed by the—introduced in the First Federal Congress.

I was going to bring two volumes with me today and neglected to bring them, but if anybody would like to see them, I would be glad to supply them.

Your members of this committee might find it fascinating to look at the first of these volumes and discover how the First Congress handled the issue of appropriations. For instance, the Appropriations Act of

March 26, 1790, alloted the sum not exceeding $155,537.72 for defraying the cost—the expenses for the Department of War. That was the entire defense budget for 1790.

Senator ABDNOR. I'm sorry, I'm going to have to rush you along here because I have to go. We've exceeded our time already, so if you could move it along.

Ms. BICKFORD. Anyway, that is my major point, that we should fund this at the $5 million level and also that the committee should look seriously at the problems in the National Archives in relation to——

Senator ABDNOR. Was that $5 million or $4 million last year?

Ms. BICKFORD. It was $4 million last year. It's authorized at $5 million, but it received $4 million last year.

PREPARED STATEMENT

Senator Abdnor, guess we'll have to recess for a few minutes.

Ms. BICKFORD. Thank you, Mr. Chairman.

[A brief recess was taken.]

[The statement follows:]

Statement of Charlene N. Bickford

I am Charlene Bickford and I represent the 56 professional organizations that are members of the Coalition to Save Our Documentary Heritage. We appreciate this opportunity to speak to the members of the subcommittee today. For 6 years this ad hoc coalition, which was formed in 1981 to protest the "zeroing out" of the grants program of the National Historical Publications and Records Commission, has come before you to plead the case for funding for the tiny, yet essential, federal participation in the preservation and publication of American historical documents. We have also urged you to look carefully at the needs of the National Archives and Records Administration and to fund that critically important government agency more adequately.

For 6 years the NHPRC's grants program has been the target of OMB examiners attempting to find ways to cut the federal budget and contain the ever expanding deficit. Yet this grants program, which received $4 million in FY'81, and the same amount (minus the 4.6% mandated by Gramm-Rudman-Hollings) in FY'86, has played no part in the increasing federal deficit. The grants program continues to be an exemplary program with the federal funds being employed to stimulate financial participation on many levels: state and local governments, private historical and archival institutions, colleges and universities, foundations, and corporations.

The Coalition supports the full authorized funding for the NHPRC's grants program. We are requesting an increase (the first in 5 years) over the current level of funding for two reasons: first, the stable level of funding for the publications portion of the program since 1974 has eroded the real dollars available for publications projects. While some of these dollars have been recovered through increased private funding, particularly the substantial grants received by the "Founding Fathers" consortium publishing the papers of George Washington, Thomas Jefferson, James Madison, Benjamin Franklin, and James Madison, this level of private foundation participation cannot be expected in the future. In fact, the two major foundations that responded generously ($1.5 million each) to appeals made in the early 1980's for five year grants have already given the "Founding Fathers" consortium firm indications that these foundations will not participate again at this level. Although foundations clearly appreciate the worth of these projects, only a limited number of them have goals consistent with supporting historical editing, and most of them prefer to support short term projects rather than projects that will require financial support into the 21st century. While we are requesting $5 million in funding, we also ask that this funding not be taken from the budget of the National Archives.

Since the arguments for continued funding for the grants program have become a little worn, although no less valid, after 6 years of this struggle, today I hope to put a little different light on the issues involved and bring you up to date on the accomplishments of Commission funded projects over the past year.

First, I would like to quote from a letter that Secretary of State Thomas Jefferson wrote to one of the earliest documentary editors in the United States, Ebenezer Hazard, upon returning the first two volumes of Hazard's Collection of State Papers.

> I learn with great satisfaction that you are about committing to the press the valuable historical and state-papers you have been so long collecting. time & accident are committing daily havoc on the originals deposited in our public offices. the late war has done the work of centuries in this business. the lost cannot be recovered; but let us save what remains: not by vaults and locks which fence them from the public eye and use, in consigning them to the waste of time, but by such a multiplication of copies, as shall place them beyond the reach of accident.

In this letter in 1791 Jefferson set the guidelines for the NHPRC: preserve historical documents and make them more available to the American people through a publication process.

The experience of the United States and her people is unique in the history of the world. This nation of immigrants has managed to sustain a stability in its form of government for nearly 200 years while the rights of individuals and the categories of individuals to which these rights apply have continued to expand. This is the history that the NHPRC seeks to preserve and make more accessible to the people of this country and those around the world who choose to study the example of the American experience. The federal government has a responsibility to continue its financial participation in this endeavor.

Since the last time that a Coalition representative sat before you, several significant publications have become available which illustrate both the breadth and importance of Commission funded projects. Last summer members of Congress and others observed the centennial of the death of Civil War General and post war President Ulysses S. Grant with ceremonials in the rotunda of the Capitol and at the Grant statue at the foot of Capitol Hill, but the publication of the last two Civil War volumes of the Papers of U.S. Grant which occurred about the same time was an event of far greater significance to posterity than any centennial ceremony. The documentation of Grant's life helps us to learn about the history of the Civil War and its aftermath by studying the leadership of that time period. In contrast, the recently published second volume of the highly acclaimed, NHPRC sponsored project, Freedom: A Documentary History of Emancipation, 1861-1867, takes a "from the bottom up" approach and provides tremendous insight into the lives of blacks in the South during this period. Reviews of Freedom have hailed the two published volumes as revolutionary new sources. In the words of Ira Berlin, the editor and project director of Freedom, "This is the fullest record that exists anywhere in the world of a people going from being slaves to being free." Although the subject matter of these two series is very different, both projects serve to illuminate a period when the United States underwent the most threatening constitutional and social crisis in its history and both rely heavily on the documentary records of the U.S. government in the National Archives.

Our nation is about to celebrate the bicentennial of the Constitution, the Congress, several of the executive departments, and our Federal Court system. The Chief Justice, as the Chairman of the President's Commission on the Bicentennial, has emphasized that this bicentennial should provide an opportunity for a "civics lesson for the nation." But the cries of celebration and the music of marching bands will have a hollow ring to them if the projects publishing the definitive documentary histories of the Ratification of the Constitution, the First Federal Elections, the First Federal Congress, and the first 10 years of the U.S. Supreme Court are slowed in their progress or even forced to close down completely because of the loss of NHPRC funds.

These projects have published a total of 7 books in the past year, including three volumes of histories of all the legislation introduced in the First Federal Congress. I have two of these volumes with me today. The members of the committee might find it fascinating to look in the first of these to discover how the First Congress handled the issue of appropriations. For instance, the Appropriations Act of March 26, 1790 allotted a sum not exceeding $155,537.72 for defraying the expences of the Department of War, which covered the entire cost of defending the United States for that year. And, the documents published or to be published in this edition are not valuable simply to the historian. In fact, just last week, the counsel for the House of Representatives who is doing research relating to the constitutional issues involved in the Gramm-Rudman-Hollings Deficit Reduction Act asked to use the First Congress Project's files of debates in the First Congress relating to the president's power of removal of executive branch officials--an issue that has come up in relation to the removal process established for the Comptroller General.

But not all of the records of the First Federal Congress have survived. The Senate had a superior archivist as its first Secretary, but the House was not so fortunate. Much of the record for the House was consciously destroyed to avoid "lumbering up the office." In addition, both the Senate and House records suffered damage from both improper storage and exposure to the elements. As an example, the original draft of the Judiciary Act of 1789, handwritten by members of the first Senate, sustained heavy damage from some kind of liquid before it was discovered in the Capitol by historian Charles Warren. If a National Archives had been in place from the beginning, such loss of and damage to the precious documents of our nation's early history might have been prevented.

As a free society we have a responsibility to give attention to our records--through support of the National Archives and the NHPRC. The NHPRC provides national leadership and stimulation for the preservation of this historical record, while the National Archives performs the essential functions of preserving and making accessible the documentation relating to the business of the federal government. This committee is responsible for funding this activity and therefore making a concentrated study of the needs of the National Archives, such as renovation of the 50 year old building on Pennsylvania Avenue and increased and more modern storage and public space in a new building on or near the mall. I would urge you to set aside the time to make such a study.

In summary, the Coalition appreciates the committee's continued support for the NHPRC's grants program and the National Archives and Records Administration and the opportunity to appear before you today.

STATEMENT OF PAGE PUTNAM MILLER, DIRECTOR, NATIONAL COORDINATING COMMITTEE FOR THE PROMOTION OF HISTORY

Senator ABDNOR. We will come to order again. Page, we'll let you go right ahead.

Ms. MILLER. Thank you very much.

I am here today representing historians and archivists. I represent particularly the American Historical Association and the Organization of American Historians. Those are the two largest associations of professional historians in the country and we, for the past 5 years, have been coming to appear before you to speak on behalf of the NHPRC grant.

I know you're familiar with these and that you have limited time today, so let me just highlight, very briefly, three points.

First, I would like to stress that the documentary editing projects which comprise at least half of these projects depend on the continuity of their professional staff and that when there is a threat of funding, some of these staff start looking elsewhere for jobs and, as you heard from Charlene Bickford's presentation, these kinds of projects depend on scholars becoming immersed in this material, whether it's the Jefferson papers or the Wilson papers and so we want very much—we are very hopeful of putting this on some secure financial standing

A second point is that these projects have a very great impact beyond the project itself. There is certainly a ripple effect and when I was recently attending, in New York, the Organization of American Historians Meeting, I met a historian from Nevada and he was telling me the

State assessment study reports that NHPRC funded just a few years back to allow States to do an assessment of their State records, that this had resulted in the development of a 5-year plan for the archives of Nevada and that, in turn, had led to the expansion of much needed staff for the State archives.

So, I think this is a way in which a Federal program, by putting a small amount of money into the State assessment study, which is part of the records side of the publications and records, has had a very significant effect.

My last point is really regarding the specific funding of this. As we come to you each year to request additional funding, it's always hard for us to—we want this additional funding, but we hope that it will not come from the operating budget of the National Archives and so my last point is to really tell you a little bit of some of the very pressing needs of the National Archives which are not being addressed in the current 1987 proposal.

First, the National Archives is faced with a severe shortage of storage and many agencies are having to store at a very expensive price, something like $12 a square foot, for storage costs, records that should be sent to the Archives, but cannot because the Archives does not have enough space and they very much need another building.

Another area of concern is just the basic preservation and care of records that are deteriorating and in this area, a recent study has shown that a large number of records in the National Archives need maintenance care and there is very little money in the current budget for this.

A third area is in the area of finding aides. Those of us who are scholars who work in the archives, we cannot find a document unless there are finding aides and only 50 percent of the material in the National Archives has finding aides.

A last area is in the area of research and development in the work on optical discs. Here again, we had hoped for funding for this, but there is only a little bit of funding in the current proposal.

So, for these reason, we would very much urge that the funding for NHPRC not come from the operating budget of the Archives. Thank you very much.

Senator ABDNOR. Thank you, Page. You make a very persuasive case. I certainly wouldn't quarrel with that. All I can say to you at this time is that we'll see how it works out, because we're kind of in the blind right now ourselves as to what might happen and you have some very strong supporters of this proposal throughout the entire committee, and I want to assure you that we heard loud and clear.

PREPARED STATEMENT

I was across town a little while ago and told him he should be here fighting the case for this.

Thank you very much.

Ms. MILLER. Thank you.
[The statement follows:]

STATEMENT OF PAGE PUTNAM MILLER

I am Page Putnam Miller, director of the National Coordinating Committee for the Promotion of History, a consortium of over 37 historical organizations.

Mr. Chairman, on behalf of the historical and archival communities in this country, I wish to express appreciation to you for being able to appear before this distinguished committee to express our views concerning the impact of the administration's fiscal year 1986 budget recommendations on the National Historical Publication and Records Commission's Grants Program and the National Archives and Records Administration. We recognize the important role of this committee in providing oversight for both the NHPRC and the National Archives.

We are most concerned, Mr. Chairman, over the fact that for the sixth consecutive year the administration's proposed budget has recommended zero funding for the NHPRC's Grants Program. In 1983 the Congress passed reauthorization legislation for NHPRC and reaffirmed the important role of this program in maintaining and enhancing our repositories of historical documents.

The $5 million appropriation which we seek—and which is the authorized fiscal year 1987 ceiling for the Grants Program of the NHPRC—is a small amount of money to pay for the thoughts of Washington, Adams, Jefferson, Madison, Clay, and Calhoun. How can we set a price on the writings of Frederick Douglas, Jane Addams, and Woodrow Wilson?

Each year for the past 5 years the historical and archival communities has come before you to describe the worthwhile work of this small program. We have stressed the fact that over one-half of the costs of these projects is contributed from the private sector. It is widely recognized that the NHPRC program has been an exemplary program for illustrating the use of Federal seed money to provide genuine leverage for eliciting funds from private sources.

I know you are familiar with the NHPRC Grants Program and thus I wish today to highlight only three points. First, the documentary editing projects, which comprise approximately one-half of the program, depend on the continuity of professional staff and to cut off funding in mid-stream would be disasterous. Second, the NHPRC records projects have a widespread and significant role in stimulating further preservation of historical records. Third, it is crucial that additional funds for NHPRC grants be added to the fiscal year 1987 appropriation instead of being taken from the already stretched budget of the National Archives.

First, continuity of staff and funding is essential. Withdrawal of Federal funds means a decrease in continuing professional staff, on which numerous projects depend. The withdrawal of Federal funding would undoubtedly mean the termination of more than one-half of the present documentary editing projects. Some of the projects likely to end if funding is lost are "The History of the First Federal Congress," the Ulysses S. Grant papers, the Freedom and Southern Society papers, and the Emma Goldman papers, among others. Many of the staff involved in these projects are scholars who have dedicated their professional careers to immersing themselves in the lives and thoughts of those whom they study. If NHPRC grants are not forthcoming, many members of documentary editing staffs will have to look elsewhere for work and their accumulated knowledge and background in the projects will be lost. To appreciate the scope of these projects and the crucial role of professional staff, consider the monumental example of the documentary editing of the papers of Thomas Jefferson. In 1950 Julian Boyd, the editor of this undertaking, published the first volume of the Jefferson papers. The last volume Boyd published before his death in 1983 was volume 20; however, at that time 35 more years of Jefferson's life had yet to be edited and published.

Assembling the pertinent papers, providing needed annotative information, and finally preparing for publication the historical texts is an enormous task. The vastness of editing projects is also displayed by the Freedom History papers which has as one of its smaller sources the records of the Freedmen's Bureau, a collection of Federal documents which contains over 700 cubic feet of material. In 1983, when NHPRC was once before forced to tighten its belt due to inadequate funding, only one of the five proposed volumes in the Freedom History papers had been completed. Since that time, with the assistance of NHPRC grants, two additional volumes in this project have been published and have received widespread recognition as major contributions to the study of American history. To summarize this first point, it is most important for those who support NHPRC grants to emphasize that when funding sources become indefinite, it is difficult to hold together the staff on whose expertise these projects rest.

Second, NHPRC grants fund projects that have a significant role in stimulating other individuals and institutions to preserve historical documents. On this point, let me give an example from the records projects, since I have already mentioned the documentary editing projects. Several years ago the National Association of Government Archives and Records Administrators received a grant from NHPRC to enable the States to assess their records programs, and to plan for the future. These State assessment studies were, and still are, aimed at producing statewide programs designed to efficiently manage and preserve records. In a recent conversation with a historian in Nevada, I learned that the NHPRC State assessment study for Nevada had led to the development of a 5-year plan for protecting the historically valuable records of the State, and that this plan had in turn led to the acquiring of additional funds for the expansion of the Archives staff for undertaking much needed labor intensive work. The records program does have tangible effects, as the State of Nevada has illustrated. The program not only involves work with specific records collections but also encourages preservation and management of records by States themselves.

And finally, let me stress a third point, that it is imperative that NHPRC grants funding not be taken from the budget of the Archives. While the administration has not recommended major cuts for the National Archives, this newly independent agency, nevertheless, faces grave budgetary problems. These are primarily derived from its recent years of subordination of the General Services Administration. As a result of this association, the Archives has much catching up to do, and there are numerous necessary projects not included in the fiscal year 1987 budget proposal. Let me list four pressing needs which are not met in the administration's budget:

One, the Archives is faced with a severe shortage of storage space and a comprehensive space plan—centered around a new building—is a necessity. Furthermore, major renovation is needed on the Pennsylvania Avenue National Archives Building to bring the building in line with standards necessary to efficiently store archival records. In discussing the status of the National Archives, we must all remain constantly aware that the National Archives does not have adequate space for receiving materials from agencies which should be transferred to the National Archives, and that many valuable records of this Nation are being kept in facilities which do not meet proper dust, temperature, and humidity standards.

Two, a recent study on the conditions of records in the National Archives has indicated that 84.5 percent of the textural records in the Archives are in need of maintenance to slow down deterioration. Intensive laboratory treatment is needed on 0.4 percent of the holdings and 4.6 percent require copying. The longer we wait to address these preservation needs the greater the risk of actually losing some documents and the greater the cost in the long run.

Three, the present budget reflects inadequate funds for needed work on finding aids. Scholars are particularly concerned about this because without descriptions of records, or finding aids, it is very difficult to gain access to records. There are no finding aids for 50 percent of the records in the National Archives, including some military records for which there are frequent requests for finding aids. A much needed automated information system would both take care of the backlog and proficiently describe new records arriving.

Four, research and development money is sorely needed to further a National Archives' pilot project on the use of optical disks. New technological possibilities are now in our grasp for preserving many deteriorating documents. This process would transfer frequently used and deteriorating genealogical records to optical disks, and would enhance the useability of records while preserving them.

I have presented in some detail information on these needs at the National Archives which are not currently being addressed and are not in the administration's budget proposal. I do this in order to urge you not to recommend that money be transferred from the National Archives' operating budget to the NHPRC Grants Program. I am here today to urge that additional funds of $5 million be made available for the NHPRC Grants Program. I request on behalf of the historical and archival communities that these funds be placed on secure footing, as they provide this country with a priceless resource: a documentation of its history.

INTERNAL REVENUE SERVICE

STATEMENT OF COL. ALFRED GRUBBS, ON BEHALF OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS

Senator ABDNOR. For the next series of witnesses for funding for the Internal Revenue Service, we will first call on Col. Alfred Grubbs representing the American Association of Retired Persons.

Colonel GRUBBS. Mr. Chairman, I'm Tom Grubbs, the volunteer tax aide coordinator for the State of Virginia.

The American Association of Retired Persons [AARP], representing the interests of 22 million Americans age 50 and older, once again welcomes the opportunity to testify before the Treasury, Postal Service and General Government Appropriations Subcommittee.

Our remarks will be brief and focus on continuing the funding for the Tax Counseling for the Elderly [TCE] Program in 1987.

At the outset, the Association wishes to commend the subcommittee for its support of the TCE Program during the past 7 years, and particularly the decision to fund TCE at $2.2 million for fiscal year 1986. This will enable more older Americans to be assisted in having their tax returns prepared. The funding has also averted the need to return to the subcommittee for additional appropriations to reimburse program volunteers for their out-of-pocket expenses in this year's tax counseling season.

Fiscal year 1987 funding for tax counseling for the elderly:

The administration's budget recommends the same $2.2 million figure for TCE for fiscal year 1987. Thus, funding would continue to be available at the same level for reimbursement of volunteer out-of-pocket expenses and other program costs. We urge the subcommittee to adopt the President's recommendation and to continue to fund TCE at $2.2 million for the coming year. Budgetary restrictions impose a duty on programs, such as TCE, to live within the limits imposed by the administration and Congress. However, the funding for TCE should be viewed against rising program costs because of the growing number of older Americans requesting help in preparing their returns.

The legislative history of this measure reveals that Congress intended that free tax counseling should be more readily available for additional elderly taxpayers because the number of older Americans would increase sharply in the years ahead. TCE has expanded dramatically since 1980, and has achieved a degree of acceptance in the elderly community that assures continuing increases in the number of applicants for the service in the future.

As a result of the $2.2 million appropriation by the Congress for TCE in fiscal year 1986, the Association's Tax-Aide/TCE Program received a total contractual arrangement of $1.9 million. This money is being expended for increased program needs reflected in current tax counseling season activities. The major part of the funding goes to defray the out-of-pocket expenses of Tax-Aide/TCE volunteer coordinators, instructors, and counselors. The request for funding for fiscal year 1987 should be viewed against the growing number of elderly, handicapped and shutin applicants needing free tax assistance.

There are clear explanations for this increased demand for the service. During the past several years, Congress has enacted major laws that have substantially changed the tax rules affecting aged and aging Americans. Again this year, major tax revision legislation is under consideration, which may substantially change the income tax rules and procedures. Many elderly are still not fully aware of these proposed tax changes and how they affect their own tax situations. They will come to the Tax-Aide/TCE sites in larger numbers during the next counseling season, February 1 to April 15, seeking information and assistance in understanding the tax changes that will probably be enacted this year. At over 7,800 Tax-Aide/TCE sites, the program will assist them by preparing their income tax returns free of charge. The Tax/Aide Program, now in its 18th year, has become virtually institutionalized as an outreach service in communities throughout the country. The elderly, the handicapped, and shutins rely on this valuable counseling by volunteers whose only reward is the service they can perform for their fellow citizens. From 850,000 tax returns prepared or assisted in 1980, the program has grown to more than 1.5 million returns this year.

The IRS has repeatedly stressed that no taxpayer should pay more than that which is legally required. Congress recognizes that many elderly persons overpay their taxes each year or file when not required to do so. Some are confused by the tax forms. Others are unaware of available deductions, credits and exemptions meant to benefit the elderly. The Tax-Aide Program assists many categories of inquiries, including those who need to file amended returns to claim deductions that they overlooked or to pay additional tax on income that was not reported.

The majority of the Tax-Aide/TCE clients have low or limited incomes. They are unable to afford the services of professional preparers for their routine returns. Those who have complicated tax situations are advised to seek professional tax assistance in preparing their returns. In recent years, the IRS has referred numerous taxpayers to Tax-Aide/TCE sites to receive assistance not always available at Government offices. This is attributed, primarily to the limited capabilities of some IRS offices to handle public inquiries because of budgetary restraints.

In addition, Tax-Aide/TCE volunteer instructions are increasingly assuming TCE training responsibilities throughout the country, to relieve IRS trainers of this responsibility. The majority of Tax-Aide volunteer counselors are now trained by instructors from within the program. As a consequence of the high capabilities of volunteer instructors, Tax-Aide counselors received more indepth instruction and frequently develop a better knowledge of the Tax Code. The result is better service for older Americans.

Without the continuation of funding at $2.2 million, it would not be possible to assure that the Tax-Aide/TCE Program will fulfill its obligations and promises to the volunteers who are incurring expenses in training and counseling activities. Nor would it be possible to assure that increased numbers of applicants would be provided with the tax assistance that new tax law changes may compel them to seek. The immediate goals of the Tax-Aide Program for 1987 are to increase the returns completed and assisted to well above the 1.5 million mark. As the number of volunteers increases beyond 25,000 nationally, the program can expand into more communities, both urban and rural, and provide assistance to large numbers of handicapped and shutin individuals. In 1985, the total number of shutins served by the Tax-Aide Program was 29,000. An additional 35,000 persons were assisted at special sites, including hospitals, nursing homes, and senior housing.

TCE has increased taxpayers' accuracy and compliance. It has provided specialized free service for groups traditionally underserved, including minorities and the rural aged.

TCE has been beneficial for our Nation's communities, the elderly, and the IRS.

And, it has developed in our people a spirit of voluntarism that increasingly makes possible the extension of governmental services throughout our communities at a minimal cost to our Nation. AARP urges your continued support of the Tax Counseling Program for the elderly.

Thank you very much.

Senator ABDNOR. Thank you, I appreciate your comments and all I can say is that we agree with you that this is an extremely valuable and important tool for people and we're just happy that the administration finally has seen the light and made it a little bit easier for your interests by including the dollars for the program.

In the past, as you know, we have had to search around and even take a little money from other areas. We're grateful for your concern and interest in this and the help that you have given us.

PREPARED STATEMENT

Without objection, your complete statement will be included in the record.

Colonel GRUBBS. Thank you very much.

[The statement follows:]

STATEMENT OF COL. ALFRED GRUBBS

The American Association of Retired Persons, representing the interests of 22 million Americans age 50 and older, once again welcomes the opportunity to testify before the Treasury, Postal Service and General Government Appropriations Subcommittee.

Our remarks will be brief and focus on continuing the funding for the Tax Counseling for the Elderly (TCE) Program in 1987.

At the outset, the Association wishes to commend the Subcommittee for its support of the TCE program during the past seven years, and particularly the decision to fund TCE at $2.2 million for fiscal year (FY) 1986. This will enable more older Americans to be assisted in having their tax returns prepared. The funding has also averted the need to return to the Subcommittee for additional appropriations to reimburse program volunteers for their out-of-pocket expenses in this year's tax counseling season.

A. FY 1987 Funding for Tax Counseling for the Elderly

The Administration's budget recommends the same $2.2 million figure for TCE for FY 1987. Thus, funding would continue to be available at the same level for reimbursement of volunteer out-of-pocket expenses and other program costs. We urge the Subcommittee to adopt the President's recommendation and to continue to fund TCE at $2.2 million for the coming year. Budgetary restrictions impose a duty on programs, such as TCE, to live within the limits imposed by the Administration and Congress. However, the funding for TCE should be viewed against rising program costs because of the growing number of older Americans requesting help in preparing their returns.

The legislative history of this measure reveals that Congress intended that free tax counseling should be more readily available for additional elderly taxpayers because the number of older Americans would increase sharply in the years ahead. TCE has expanded dramatically since 1980, and has achieved a degree of acceptance in the elderly community that assures continuing increases in the number of applicants for the service into the future.

As the result of the $2.2 million appropriation by the Congress for TCE in FY 1986, the Association's Tax-Aide/TCE program received a total contractual arrangement of $1.9 million. This money is being expended for increased program needs reflected in current tax counseling season activities. The major part of the funding goes to defray the out-of-pocket expenses of Tax-Aide/TCE volunteer coordinators, instructors and counselors. The request for funding for FY 1987 should be viewed against the growing number of elderly, handicapped and shut-in applicants needing free tax assistance.

There are clear explanations for this increased demand for the service. During the past several years, Congress has enacted major laws that have substantially changed the tax rules affecting aged and aging Americans. Again this year, major tax revision legislation is under consideration, which may substantially change the income tax rules and procedures. Many elderly are still not fully aware of these proposed tax changes and how they affect their own tax situations. They will come to the Tax-Aide/TCE sites in larger numbers during the next tax counseling season (February 1 to April 15) seeking information and assistance in understanding the tax changes that will probably be enacted this year. At over 7,800 Tax-Aide/TCE sites, the program will assist them by preparing their income tax returns free of charge. The Tax-Aide program, now in its eighteenth year, has become virtually institutionalized as an outreach service in communities throughout the country. The elderly, the handicapped, and shut-ins rely on this valuable counseling by volunteers whose only reward is the service they can perform for their fellow citizens. From 850,000 tax returns prepared or assisted in 1980, the program has grown to more than 1.5 million returns this year.

The IRS has repeatedly stressed that no taxpayer should pay more than that which is legally required. Congress recognizes that many elderly persons overpay their taxes each year or file when not required to do so. Some are confused by the tax forms. Others are unaware of available deductions, credits and exemptions meant to benefit the elderly. The Tax-Aide program assists many categories of inquirers, including those who need to file amended returns to claim deductions that they overlooked or to pay additional tax on income that was not reported.

The majority of the Tax-Aide/TCE clients have low or limited incomes. They are unable to afford the services of professional preparers for their routine returns. Those who have complicated tax situations are advised to seek professional tax assistance in preparing their returns. In recent years, the IRS has referred numerous taxpayers to Tax-Aide/TCE sites to receive assistance not always available at government offices. This is attributed, primarily to the limited capabilities of some IRS offices to handle public inquiries because of budgetary restraints.

In addition, Tax-Aide/TCE volunteer instructors are increasingly assuming TCE training responsibilities throughout the country, to relieve IRS trainers of this responsibility. The majority of Tax-Aide volunteer counselors are now trained by instructors from within the program. As a consequence of the high capabilities of volunteer instructors, Tax-Aide counselors received more in-depth instruction and frequently develop a better knowledge of the tax code. The result is better service for older Americans.

Without the continuation of funding at $2.2 million, it would not be possible to assure that the Tax-Aide/TCE program will fulfill its obligations and promises to the volunteers who are incurring expenses in training and counseling activities. Nor would it be possible to assure that increased numbers of applicants would be provided with the tax assistance that new tax law changes may compel them to seek. The immediate goals of the Tax-Aide program for 1987 are to increase the number of returns completed and assisted to well above the 1.5 million mark. As the number of volunteers increases beyond 25,000 nationally, the program can expand into more communities, both urban and rural, and provide assistance to large numbers of handicapped and shut-in individuals. In 1985, the total number of shut-ins served by the Tax-Aide program was 29,000. An additional 35,000 persons were assisted at special sites, including hospitals, nursing homes and senior housing.

TCE has increased taxpayers' accuracy and compliance. It has provided specialized free service for groups traditionally underserved, including minorities and the rural aged.

TCE has been beneficial for our nation's communities, the elderly and the IRS.

And, it has developed in our people a spirit of volunteerism that increasingly makes possible the extension of governmental services throughout our communities at a minimal cost to our nation. AARP urges your continued support of the Tax Counseling program for the elderly.

B. Revenue Foregone

Mr. Chairman, the Association further urges the Subcommittee to approve full funding for revenue foregone for private, nonprofit organizations for FY 1987. This would require $833.2 million. Of this total, $774.235 million would actually be available to reimburse the U.S. Postal Services for services to blind persons and the reduced rate mail for nonprofit sponsors. The remaining $58.976 million represents a reconciliation adjustment based on audited FY 1984 volumes.

Congress created the postal subsidy, in large part, because private, nonprofit organizations complement or even substitute for publicly funded government activities at all levels--federal, state, and local. The workload and cost for governmental agencies would be greatly increased if the private, nonprofit sector did not deliver a considerable portion of supportive services. These services, in many cases, enable the recipient to live independently and without the necessity of seeking help from governmental programs. Thus, governmental units recognize savings, either directly or indirectly, from the activities of private, nonprofit organizations.

Many of these services, though, would be sharply curtailed or perhaps eliminated totally if Congress does not provide funding for the revenue foregone appropriation. Reduced postal rates have enabled private, nonprofit organizations to devote more resources to charitable, educational, and other beneficial public activities. We believe that it is sound public policy to promote these activities by the private sector through the establishment of reduced postal rates.

This rationale becomes even more compelling now. Funding for supportive services has been cut markedly in recent years. Supporters of these reductions have often maintained that the private sector could pick up the slack. These funding cutbacks will be even more pronounced as the Gramm-Rudman-Hollings balanced budget amendment becomes fully effective.

The bottom line is that the private sector will be asked to do more to complement government activities. However, it is absolutely essential for private, nonprofit organizations to have access to a mail system at a reasonable and affordable cost in order to fill these gaps.

The private, nonprofit sector is already reeling from the effects of three significant postal rate hikes since February 17, 1985. Two of these have already occurred this year alone. For example, the rate for third class nonprofit mail has jumped by 67 percent, from 5.2 cents prior to February 17, 1985 to 8.7 cents currently. Similarly, a 67-percent hike has occurred for 5-digit presort mail, from 4.3 cents to 7.2 cents. Carrier route presort mail has risen by a whopping 73 percent in slightly more than a year, from 3.3 cents to 4.7 cents currently.

Elimination of the revenue foregone appropriation or a substantial reduction for the postal subsidy will, in our judgement, be counterproductive. It will not only affect the ability of the private sector to deliver services by driving up operating costs, but it will also impede efforts to raise funds to carry out these activities.

The 1970 Postal Reorganization Act and subsequent amendments established a permanent funding mechanism for the "continuing appropriation" for the revenue foregone postal subsidy. This was designed to insulate nonprofit mailers from substantial hikes in mailing costs. The underlying philosophy for this measure was that postal rate increases for nonprofit mailers should be both predictable and moderate.

This philosophy made good sense then, and it does now--especially during a period when federal support for services is diminishing while the public demand is increasing. For these reasons, we strongly reaffirm our support for full funding for the revenue foregone appropriation.

STATEMENT OF MARK N. COHEN, CHAIRMAN, ENFORCEMENT LIAISON COMMITTEE, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION; DIRECTOR, DIVISION OF ENFORCEMENT AND COMPLIANCE, PENNSYLVANIA SECURITIES COMMISSION

Senator ABDNOR. Mark Cohen representing the North American Securities Administrators Association.

I think earlier you may have heard your entire statement will be made part of the record.

Mr. COHEN. We appreciate the subcommittee's decision to enter the entire statement as part of the record.

My name is Mark N. Cohen and I am chairman of the Enforcement Liaison Committee of the North American Securities Administrators Association [NASAA] and director of the Enforcement and Compliance Division of the Pennsylvania Securities Commission.

Among NASAA's members is the entire 50 States securities commissions nationwide and NASAA works to maintain the integrity of the securities markets, to protect investors and to prevent and curb abusive practices.

Mr. Chairman, a Deborah Bollinger, who was director of the South Dakota Securities Commission has asked me to convey her good wishes to you should I be fortunate enough to be before you today.

Senator ABDNOR. She's a great young lady, I can assure you. She worked for us for awhile.

Mr. COHEN. Does that get me 10 more minutes though?

As you have heard on other occasions, we have heard a test for obscenity that you really can't define obscenity but you know it when you see it. When it comes to abusive tax shelters, the securities administrators have what they call smell tests. It's hard to define abusive tax shelter, but we know it when we smell it and I would just like to bring into focus something today on abusive tax shelters.

As we sit right here this moment, a multi-State coordinated effort by Pennsylvania, Florida, and Oklahoma, is resulting in lawsuits being filed against persons operating a boiler room from Fort Lauderdale and soliciting victims nationwide in oil and gas wells. This group has brought a new twist to their operation by baiting their hooks with the lure of legitimacy courtesy of the U.S. Government.

These wells are alleged to be located on the untapped reserves of Indian land. Now that the Comanche has found a white man that they can trust, they're willing to do business. Of course the promoters tout the fact that drilling on Indian land requires the approval of the Department of Interior, Bureau of Land Management, and the Bureau of Indian Affairs and all things being equal, that's a fair statement and how legitimate can that appear.

But, these scammers speak with forked tongues. Investors have been baited and switched from well sites on Indian land in Oklahoma to nonproductive holes in Ohio and it's scams like this that the General Accounting Office has estimated rob the U.S. Treasury of an amount equal to the IRS's entire appropriation which I think is about $3.8 billion.

Now, what can we do about this situation and how can we help with the IRS?

Well, Congress when they passed the Tax Equity and Fiscal Responsibility Act went a long way in providing the Internal Revenue Service with the tools to operate and fight these abusive tax shelters. Section 6700 and 7408 provide the opportunity for the current year civil penalties and injunctions against these promoters and this is attacking the shelter at its source, the promoters and pitchmen before the order process has begun. This would put our enforcement emphasis where it should be, on preventive enforcement at the front end of a shelter program.

Now, the IRS has been pitifully inefficient in utilizing these measures that Congress has given it. Now, we don't know whether it's because of bureaucratic inertia, lack of resources or inexperience, but the IRS has not adequately implemented the congressional intent to stop the ongoing abuse of tax shelter offerings before the filing of investor returns.

It is urged that Congress increase or the IRS reallocate the resources and manpower to effectively implement the promoter penalty and injunction provisions of TEFRA.

The enforcement of the investor audit level is too little and too late, enormously wasteful limited resources and loses sight of their promoter as the primary target.

The other aspect that we would like to address is the sharing of information. Too often this has been a one-way street with the Internal Revenue Service. Just last week I received a letter from the Philadelphia branch office requesting information on the tax shelter we referred to the IRS about 6 or 8 months ago, after we enjoined their operation in court and the letter is fairly typical requesting or even responding, which is something, but 6 or 8 months later we get the letter requesting that we open up our investigative files and they would like to meet with our staff to discuss the matter.

Senator Abdnor. Who is that now?

Mr. Cohen. This is the Chief of the Examination Division of the IRS in the Philadelphia district office.

And, this is somewhat typical. The IRS loves to get information, but they're very reluctant to give any. As a matter of fact they don't and what they always say is, well, 6103 of the Internal Revenue Code says that taxpayer information, tax return information is not public information. And that's fair as far as it goes, but I think the Internal Revenue Service has gone overboard in interpreting what taxpayer information is.

Now, it's evident that information gathered by IRS agents, during an investigation of an abusive tax shelter would result in securing information like promotional material, projections, order reports, appraisals, evaluations, the identity of the true promoters and so on and they have always said, well we can't give you any of this information, this is nonpublic information and it's confidential.

We feel that's ridiculous, that this information is not taxpayer related information, it's not covered by the Code and that this information should be shared with the States.

In fact, in a similar vein, we would authorize and we would allow that this information only be utilized in adjudicatory or proceedings in which the State is a party. As a similar action, Congress recently amended section 8(e) of the Commodities Exchange Act to provide and foster just such information sharing with the CFTC. We think something along these lines should be utilized with the Internal Revenue Service.

The final aspect that has been brought to my attention by a couple of States concerns conditions in which a States security administrator has filed, in court, and got an injunction against an abusive tax shelter program. And, as luck would have it, we're able once in awhile to seize these assets before they're spent or sent offshore somewhere.

And, the securities administrator wants to distribute these assets of the promoter to the defrauded investors, usually it's maybe only 10 cents, 20 cents on a $1 to the people who have been duped by these con artists.

Then the IRS comes in and slaps a lien on the assets and the IRS says, no, we want to keep this money for the Treasury and the only way the IRS would relent in a situation like this would be if the State securities administrator can prove in court and trace the funds from the investor to the promoter through the banking system and being held and used in a constructive trust by their promoter to the benefit of the investor.

This is almost impossible to do. It's very time consuming and we would urge that the Internal Revenue Service not make the States jump through hoops in order to get some money returned to defrauded investors.

Just in conclusion, the States have been fighting on the front lines of these battles for a long time, but too often our defense are fragmented by geographical boundaries, limited jurisdiction and scarce resources.

We would urge the subcommittee's report to recommend to the Federal authorities and especially Internal Revenue Service, to join the States in our battles against abusive tax shelters and join our battles like this as truly equal partners. Thank you.

Senator ABDNOR. Thank you, Mr. Cohen. I didn't even have to give you those extra minutes you earned by your nice comments.

I think we all agree with you about tax shelters. We hope that Senator Packwood, who is working on legislation up there, I don't know what he'll do with it, but these are things we could do, if we would just follow your advice.

Now, we do confer with the IRS and talking here, very definitely, one thing to do is send this testimony down to Mr. Eggers himself and ask him to take a look at it and see what he has to say. But we'll do everything we can because this is a strong point that isn't right nor fair.

Mr. Cohen. We appreciate, Mr. Chairman and we often, speaking from the State's viewpoint, we also have a situation when we talk with a Federal agency who has concurrent jurisdiction with us in certain areas like the SEC and the IRS in the abusive tax shelter areas, we often find great resistence from the Federal authorities and that they are very jealous of turn battles, of taking things over and always looking at the States as being the stepchild that, you know, you don't know what you're talking about, let big government handle things and so on and they always want to take from you, but when it comes to actually joining hands and recognize that we should be on the same side of these battles, it's very few and between that we find anybody who will cooperate.

Once in awhile, we do get good personal relationships in the field, with the district offices, but we feel that the marching orders have to come from Washington, from headquarters into the field to urge a true cooperative effort in law enforcement.

PREPARED STATEMENT

Senator Abdnor. I understand that and we appreciate your thoughts and maybe we can work together on this and make some headway. Thank you very much.

Mr. Cohen. Thank you, Mr. CHairman.

[The statement follows:]

STATEMENT OF MARK N. COHEN

The North American Securities Administrators Association (NASAA) appreciates the opportunity to appear before this Subcommittee in connection with hearings on the proposed Internal Revenue Service (IRS) budget for fiscal year 1987. My name is Mark N. Cohen. I am Chairman of NASAA's Enforcement Liaison Committee and Director, Division of Enforcement and Compliance of the Pennsylvania Securities Commission. NASAA is a 68-year-old association of the 65 state and provincial securities administrators from the United States, Canada and Mexico. Individually, we are charged with the responsibility for administering and enforcing securities laws in our various jurisdictions. NASAA works to maintain the integrity of the securities markets, to protect investors, and to prevent and curb abusive practices.

Two inter-related issues impact upon that function and mesh closely with the enforcement program of the IRS. Those issues are abusive tax shelters and the sharing of investigative information.

More than $10 billion in tax sheltered investments were sold in this country in 1985. The General Accounting Office has estimated that abusive tax shelters rob the Treasury of $3.6 billion per year. While tax shelters are not always abusive, an abusive tax shelter is almost always a security.

On this subject, there should be no need to engage in political niceties. It's time for the IRS to declare war on abusive tax shelters and Congress should support that effort with money, manpower and marching orders direct from Washington to the district offices.

The state securities administrators have been fighting in the trenches against the recent onslaught of the middle class, mass marketed abusive tax shelter. The enemy directing this assault is cunning, resourceful, outwardly respectable, utterly ruthless and possesses a voracious appetite that feeds off the American pocketbook. The fortifications erected by the states are too often fragmented by geographical boundaries, limited jurisdiction and scarce resources. These breaches in law enforcement must be secured by closer state-federal cooperation.

Taking aim at abusive tax shelters presents an elusive target because of all its possible permutations. There's the "I know it when I see it" test for obscenity. When it comes to abusive tax shelters, state securities administrators "know it when they smell it." Tax shelters start to stink when you find artificial transactions, inflated appraisals, high leverage, nonrecourse liability, guaranteed write-offs, legal defense funds, guaranteed payoffs, little or no investor participation, use of off shore entities, inconsistencies between written and oral representations, lull letters, backdated documents, switching of properties, egregious front end fees and boiler room operations pushing schemes lacking in economic reality.

As the tax code changes and world economies shift, we see money running for shelter from real estate partnerships and oil and gas wells to computer software, equipment leasing, videotape master recordings, Arabian race horses and Rex rabbits. Our experience shows that these schemes not only multipy like rabbits, they're also hard to snare.

Such shelters produce none of the economic or social benefits that Congress seeks to encourage through the use of legitimate shelters. Instead, money is siphoned from legitimate investment opportunities to line the pockets of the promoters. Such scams have a ripple effect on the investing community and wash out the seed money for new businesses and jobs.

Last year, NASAA brought to your attention the multi-state effort taken against the American TV or Videogram shelter which involved the production and distribution of videotapes of song and dance segments for TV variety programs.

As we sit here today, another multi-state effort, coordinated by Pennsylvania, Florida and Oklahoma, is resulting in law suits being filed against persons operating a boiler room from Fort Lauderdale and soliciting victims nationwide to invest in oil and gas wells. This group has brought a new twist to their operation by baiting their hooks with the lure of legitimacy, courtesy of the U.S. Government.

These wells are alleged to be located on the untapped reserves of Indian land. And now that the Comanche Nation has found "a white man they can trust," they're willing to do business. Of course, the promoters tout the fact that drilling on Indian land requires the approval of the Department of Interior, Bureau of Land Management and Bureau of Indian Affairs. All things being equal, that would be a fair enough statement. But these scammers speak with forked tongue. Investors have been baited and switched from well sites on Indian land in Oklahoma to non-productive holes in Ohio.

So what is there to do about the situation? We applauded the action taken by Congress in passing the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Prior to TEFRA, the IRS audit program was at least 3-5 years behind the current year. By that time, the promoters were usually long gone; or, if caught, the money was long gone--either spent or off shore. Often it was the duped investor that ended up paying back taxes and penalties that easily could add up to twice the initial investment in the tax shelter. With the state securities administrators being cognizant of current year filings and solicitations, there was little incentive to cooperate with the IRS. The high hopes and expectations that came with the passage of TEFRA have gone largely unrealized although the potential still remains. Sections 6700 and 7408 provide the opportunity for current year civil penalties and injunctions against promoters. This is attacking the shelter at its source--the promoters and pitch men, before the audit process has begun. With the use of prefiling notification to investors[1] and the registration requirements of the Deficit Reduction Act of 1984[2] the IRS has been given the opportunity to join the states in some degree of market regulation. This would put our enforcement emphasis where it should be--on preventive enforcement at the front end of a shelter program.

Whether because of bureacratic inertia, lack of resources and/or inexperience, the IRS hasn't adequately implemented the Congressional intent to enjoin ongoing abusive tax shelter offerings before the filing of investor returns. It is urged that Congress increase and/or the IRS reallocate resources and manpower to effectively implement the promoter penalty and injunctive provisions of TEFRA. Enforcement at the investor audit level is too little, too late, enormously wasteful of limited resources and loses sight of the promoter as the primary target.

The IRS has moved to establish tax shelter program coordinators in each district director's office. A national tax shelter coordinator has also been established, although this position has been held by three different persons over the past two years, which certainly doesn't help program continuity. NASAA's Enforcement Liaison Committee has a member designated to the IRS to assist enforcement liaison efforts.

Once TEFRA is utilized as it should be, it remains to be seen whether the state securities administrators and the IRS can offer mutual assistance in combating abusive tax shelters. Presently the states haven't gotten much of anything from the IRS, except press announcements when the Tax Division of the Department of Justice files suit. While many states have opened their files to agents of the IRS, this flow of information has been travelling down a one way street. The reason cited by the IRS for its inability to share any information with the states on abusive tax shelter cases is Section 6103 of the Internal Code (which holds tax returns and tax return information to be confidential). While not presently advocating a statutory amendment, we are advocating the implementation of a more reasonable reading of the statute.

It is evident that information gathered during the investigation of a suspected abusive tax shelter would likely result in the securing of promotional materials, statements, audit reports, appraisals, reserve information, projections, development status information, names of other investors, the identity of the true promoters, etc., by IRS agents. This should not be considered tax return information. Why not make this information available to the states under condition that it not be disclosed except in connection with an adjudicatory action or proceeding to which the state is a party? Congress recently amended Section 8(e) of the Commodity Exchange Act to provide and foster just such information sharing. There should also be a concerted effort to assist the states by providing technical support such as expert testimony, appraisal and valuation assistance.

In cases settled or brought before a court in equity, the attorneys in the Tax Division should fashion equitable prayers for relief which would build in requirements of the promotor to notify the IRS of future tax shelter activity complete with all offering and promotional materials, investors' names and addresses and the waiver of any restriction on dissemination of this information to any state or federal governmental agency.

In many parts of the country, effective personal contacts have been developed between a state and a district office. However, the direction from headquarters to the field has not come through loud and clear that we are on the same side of this battle. There's more than enough unlawful activity going on to keep all of us busy, so why not explore all possible avenues of sharing investigative information and affording each other prosecutorial assistance.

A final point I'd like to address is one that has been brought to my attention by a number of states and concerns a situation that has brought these states into conflict with the IRS. The situation arises when a promoter, convicted of securities fraud in an abusive tax shelter case, has had assets frozen by the state court. The securities administrator wishes to liquidate assets and distribute the funds to the defrauded investors while the IRS wants the money turned over to the Treasury, and slaps a lien on the assets. While the state has shown that these assets were acquired as a direct result of defrauding investors of their money, the IRS steadfastly insists on keeping the assets unless the state can trace each person's investment to the promoter through the banking system and to its ultimate utilization on behalf of the investor. The IRS will relent only if the state court finds that the assets are not that of the promoter but are held in a constructive trust for the investor. This tracing of funds and legal construction of trust theory is usually a most difficult and time consuming one to establish and we would urge the IRS to relent on this policy and not force the states to jump through endless hoops in an attempt to return money to defrauded investors.

We stand ready and willing to meet with the IRS to explore these matters and others of mutual concern in a joint effort to combat abuses to our tax system and securities markets.

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1. Based on a review of the promotion, if IRS believes that the tax deduction is not allowable and if the deduction is taken anyway, the taxpayer's return will be audited.
2. Requires the principal organizer of a tax shelter to register the tax shelter with the IRS on Form 8264 not later than the day of the first offering and requiring the tax shelter number be given to each investor to report on Form 8271 if they wish to claim any deduction.

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

STATEMENT OF BRUCE SILVERGLADE, DIRECTOR OF LEGAL AFFAIRS, CENTER FOR SCIENCE IN THE PUBLIC INTEREST

Senator ABDNOR. I am going to return, with the forgiveness here of Mr. Tobias and hope Mr. Tobias will understand that we want to go back to Mr. Silverglade and finish up on the Bureau of Alcohol, Tobacco and Firearms, particulary since Mr. Tobias will be touching on the subject we have coming up right after this.

Mr. Silverglade, we welcome you to the committee, once again, and proceed anyway you care to. Your entire statement will be made a part of the record. I guess we do have a time restriction because we have a number of witnesses yet to be heard.

Mr. SILVERGLADE. Thank you and I apologize for being absent from the room for what turned out to be a short floor vote.

Mr. Chairman, as you know, we're interested in section 508 of the current fiscal year 1986 appropriations law. That provision prohibits the Bureau of Alcohol, Tobacco and Firearms from implementing an ingredient labeling regulation for alcoholic beverages unless ordered to do so by the Federal courts and the provisions specify that that has to be a final court order after all appeals have been heard.

As you know, we have been in courts, Federal district court and the U.S. court of appeals here in Washington, suing the Treasury Departments Bureau of Alcohol, Tobacco and Firearms in an attempt to get that agency to reinstate the regulation for ingredient labeling of alcoholic beverages.

Our position, throughout this issue, over the last 4 years, has been that ingredient labeling is an essential public health measure. There are more that 1.5 million Americans, according to the Treasury Department's own estimates, that are allergic or otherwise sensitive to the more than 250 different ingredients that can be used in alcoholic beverages and these people unknowingly play Russian roolette everytime they have a beer, cocktail or a glass of wine.

Now, I am very sad to report that since we testified on this issue last year, a person, a Texas man, died after drinking wine preserved with sulfiting agents and had ATF never rescinded this rule in 1981, this person might, indeed, be alive today.

Now, we have been saying for years that these ingredients can cause reactions, serious reactions and now someone has died from an ingredient that is still in use. It's important to get these ingredients on the labels.

Now, last year this subcommittee took action to insure that the Bureau of Alcohol, Tobacco and Firearms would be allowed to issue a regulation to require the labeling of the single preservative that happened to kill this man. That's not really the whole story though.

As I said, more than 250 different ingredients, used in beer, wine, and liquor and dozens of, according to the medical literature, according to the Food and Drug Administration during the Ford, Carter, and Reagan administrations, can cause similar reactions. Fortunately, no one else has died yet, but the idea is to get these things on the label before anybody else does die.

Now, with my remaining time, I would like to update you on the status of the litigation against ATF.

Federal district court again, for the second time, ordered, last October, that ATF reinstate the ingredient labeling regulation by April 30 of this year. The court was aware of the language in H.R. 3036 from last year saying that the agency couldn't use funds to take that action until all appeals have been heard but nonetheless, the district court, Judge Craft, felt that this was such an urgent matter that he issued the order notwithstanding.

The court of appeals though, upon reviewing the language in the current law didn't want to place ATF between a rock and a hard place and said since they didn't have any money to comply with the court order, that it would be stayed pending appeal. But, shortly thereafter, the U.S. court of appeals decided to expedite the entire case to that they could resolve this matter quickly in light of the public health concerns.

That process is moving smoothly now. We will argue the case in court and the Government will argue its side in court on May 23 and we expect a decision by the end of the summer when the court adjourns for the season.

So, while we oppose the restrictions in the current law, they have run their course. We are expecting final action from the court of appeals. The distilled spirits industry has intervened in the case and the Government will certainly have an opportunity to appeal to the Supreme Court but I frankly don't believe that the Supreme Court will be interested in this issue and so, hopefully, this decision, we expect by the end of the summer will be the end of it and the language in the current law has had its effect of staying an order for ingredient labeling pending all appeals and we hope that that is simply the end of the matter.

That the time has come for this subcommittee to stop meddling in this area which we feel has been thoroughly adjudicated in the courts and which is an essential public health measure. Thank you.

Senator ABDNOR. Well, thank you, Mr. Silverglade. I assure you that this is what we have been hoping for, some decision out of these courts and once it is done, we will proceed in everyway that we can. We were hesitant because of the pending litigation in the courts. I have some of my own constituents write me in the middle of a case and want me to do something. And, I have just never made a practice to interject ourselves in that. We're happy that you're reporting to us today that something is going to come to a head the end of May.

PREPARED STATEMENT

Hopefully this thing is going to be settled once and for all. Thank you very much.

Mr. SILVERGLADE. Thank you for the opportunity.

[The statement follows:]

STATEMENT OF BRUCE SILVERGLADE

Good afternoon. My name is Bruce Silverglade. I am Director of Legal Affairs at the Center for Science in the Public Interest (CSPI). With me today is Mitchell Zeller, an attorney in our Office of Legal Affairs.

The Center is a non-profit consumer health organization and has had a longstanding interest in improving national health policies. CSPI is supported by individual donations of our approximately 70,000 members.

Since 1972, we have worked to improve regulation of alcoholic beverage labeling. Today, I would like to address two matters of great concern to us: ingredient labeling and calorie labeling of alcoholic beverages.

Alcoholic Beverage Ingredient Labeling

Ingredient labeling is an essential public health measure. The Treasury Department itself estimated that at least one and one-half million Americans are allergic to the more than 250 different ingredients that can be used in alcoholic beverages. See Attachments 1 and 2. These persons unknowingly play Russian roulette every time they have a beer, cocktail, or a glass of wine. Adverse reactions to alcoholic beverages range from runny nose to gasping, wheezing, and choking. Tragically, the record will show that in some cases, inadvertent consumption of brands containing certain ingredients can be fatal. Just last July, a Texas man died after drinking a few sips of wine preserved with sulfiting agents. See Attachment 3. Had the use of this preservative been disclosed on the label, this person would likely still be alive today. As the Food and Drug Administration specifically stated in a memorandum to ATF, "reliance on ingredient declarations may be the only practicable means for [such] consumers to avoid the offending substances." See Attachment 4.

Not surprisingly, ingredient labeling of alcoholic beverages has widespread public support. In a Gallup poll conducted for the National Council on Alcoholism in 1983, 61 percent of Americans stated they favor a federal regulation requiring ingredient disclosure of alcoholic beverages. See Attachment 5. We further note that the Consumer Federation of America, which represents hundreds of consumer organizations, has endorsed ingredient labeling in its 1986 policy resolution statement.

This subcommittee has taken substantial interest in BATF's regulation of ingredient labeling. As you know, Mr. Chairman, BATF issued final regulations requiring ingredient disclosure in 1980 but rescinded the regulations in 1981. That action was reversed by the United States federal district court here in Washington in 1983. The court ordered that the regulation be reinstated no later than February 8, 1984. BATF initially complied, but then rescinded the rule once again in October, 1983. That action was challenged and the federal district court once more reversed BATF.

In its most recent ruling, the district court stated that BATF exhibited a "predetermined mindset" to rescind the regulation and ignored the most probative evidence on the administrative record before the agency, including published medical reports, cost-benefit studies and other crucial material. The district court further noted that a large percentage of the agency's statement of basis and purpose for rescinding the rule the second time was copied verbatim from briefs submitted by the administration and the Wine Institute (an intervenor) in the intial litigation. The district court had already rejected the arguments in these briefs more than two years before, and was not happy to learn that BATF had attempted to put this entire issue on a legal merry-go-round. This committee should be similarly displeased with BATF's behavior. Such attempts at legal maneuvering are not befitting to the Justice Department and threaten to undermine the entire administrative process. See Attachment 6.

Upon reversing BATF's latest attempt to rescind the ingredient labeling regulations, the district court ordered that the regulation to reinstated by April 30, 1986. Had the district court's order been allowed to take effect, we would begin seeing ingredient information on beer, winand liquor labels in less than two weeks. Members of the public would no longer be in danger of dying, or falling into a coma by accidently drinking an alcoholic beverage which contained a substance to which they were allergic. The court of appeals, however, felt compelled to stay the district court's order pending the administration's and the liquor industry's second attempt to appeal this case. The court of appeals took this action because this committee denied BATF funds to implement the ingredient labeling regulation until the district court's order is upheld on appeal.

While we have disagreed with this committee's action, we now note that a court of appeals decision is expected shortly. Should the district court order be upheld on appeal, as we fully expect it will, the language in the current bill will allow BATF to comply with the court's decision and the public will soon know whether their glass of wine, beer, or liquor contains an additive they must avoid in order to protect their health.

With all due respect, we must state that the time has come for this committee to stop meddling in this matter and let the judicial process work. The industry's desire to hide the ingredients it uses from public scrutiny has been widely reported on national television, See Attachment 7, and this committee's attempts to deprive the public of ingredient information is increasingly becoming the subject of editorial comment. See Attachment 8. Consumers are not going to stand for being kept in the dark much longer. As the Los Angeles Times stated the last time Congress acted on Treasury appropriations, Congress will soon vote "on a measure that could prolong [an] unhealthy ingorance... Alcoholic beverage ingredients can cause adverse health effects in sensitive individuals."

Alcoholic Beverage Calorie Labeling

Alcoholic beverages -- beer, wine and distilled spirits -- contain significant levels of calories and can contribute to obesity, a problem of concern to millions of consumers. The range of calorie content in different brands of alcoholic beverages is great. Beer contains 70-170 calories per 12 ounces, a glass of wine between 60-135 calories, and a jigger of liquor 95-125 calories. See Attachment 9. Yet, calorie-conscious consumers find it difficult, if not impossible, to determine the calorie content of alcoholic beverages because current regulations do not require that calorie information be listed on all container labels. At this time, BATF regulations require only manufacturers of "light" (low-calorie) beverages to list calorie information on labels.

Furthermore, the variation in calorie content of so-called "light" alcoholic beverages is great. Hence, the term "light" confuses and misleads consumers. For example, light beers contain between sixty-eight and one hundred and thirty-four calories. Id. At least one light beer appears to provide more calories than a competitor's regular brand. The inability to compare the calorie content of "light" and regular beer products renders informed purchasing decisions virtually impossible.

Millions of Americans are extraordinarily concerned about obesity. According to one newspaper account, the public spends $10 billion annually on diet books, pills and other aids. Health and Nutrition Examination Survey (HANES), National Center on Health Statistics, August 30, 1979. That figure is undoubtedly much higher today. Such statistics indicate that consumers are hungry for information that may assist them in the battle of the bulge. Calorie labeling will be an obvious benefit to weight-conscious people, and will help reduce the incidence of obesity in America today.

In a 1979 FDA study of citizen comments on food labeling, sixty-two percent of the majority of the commenters who used nutritional information labeling chose calorie content as the most important piece of information that could be provided. 44 Fed. Reg. 75,995 (December 21, 1979). In addition, an FDA-sponsored Consumer Food Labeling Survey, conducted in 1978, concluded that consumers ranked the provision of calorie content information as the highest priority food label revision that they desired. Id.

Consumers are willing to incur higher prices for products containing nutritional information. The Food and Drug Administration undertook a survey of consumers' nutrition knowledge in 1975. One measure of shoppers' attitudes towards nutrition labeling was obtained by asking them if they would be willing to pay extra (up to fifty cents each week) so that this information could be put on food products. Two-thirds of those surveyed were willing to pay at least ten cents more each week for nutritional labeling. In spite of this very high demand for calorie information, the vast majority of alcoholic beverages do not contain this vital information.

In 1983, my organization filed a petition with BATF requesting mandatory calorie labeling of alcoholic beverages. See Attachment 10. In that petition we suggested that a limit be placed on the calorie content of "light" alcoholic beverages to prevent products that contain up to 134 calories in a 12-ounce serving from bearing a "light" claim.

We recommended that "light" beers contain no more than 100 calories per serving. The Miller Brewing Company also urged BATF to adopt the 100-calorie limit. See Attachments 11 and 12. Miller made this recommendation in comments submitted to BATF in 1979 and 1981.

We note that in BATF's semi-annual Regulatory Agenda announcement last April, the agency expected to publish a request for public comment on our petition in September, 1985. 50 Fed. Reg. 17,628 (April 28, 1985). In its October, 1985 Regulatory Agenda, BATF retreated from its earlier position. While it still intended to seek comments, the action timetable in the announcement stated "Next Action Undetermined." 50 Fed. Reg. 44498 (October 29, 1985). We understand that the Office of Management and Budget has prevented the agency from taking the minimal step of soliciting public comment on the need for calorie labeling.

Congress has previously opposed OMB interference in BATF's label approval processes and the agency's general labeling responsibilities under the Federal Alcohol Administration Act. Last year, Congress agreed to an amendment in the continuing resolution for the government's Fiscal Year 1986 appropriations that prevents OMB from revising or curtailing BATF's power to issue certificates of label approval. H.J. Res. 450; see H. Rep. 99-450, Amendment No. 130, p. 378, 99th Cong., 1st Sess. (1985). We urge this committee to vigorously oppose any similar efforts by OMB to prevent BATF from exercising its power under Section 205 of the Federal Alcohol Administration Act by seeking public comment on the need for mandatory calorie labeling of alcoholic beverages.

We would like to thank the committee for this opportunity and we would be glad to answer any questions concerning our testimony.

ATTACHMENT 1

[Federal Register, Vol. 45, No. 116, June 13, 1980]

DEPARTMENT OF THE TREASURY

Bureau of Alcohol, Tobacco, and Firearms

27 CFR Parts 4, 5, and 7

[T.D. ATF-66; Ref: Notice No. 314]

Labeling and Advertising of Wine, Distilled Spirits, and Malt Beverages

AGENCY: Bureau of Alcohol, Tobacco, and Firearms (ATF).

ACTION: Final rule; Treasury decision.

SUMMARY: This rule amends 27 CFR Part 4, Part 5, and Part 7 (Labeling and Advertising of Wine, Distilled Spirits, and Malt Beverages under 27 U.S.C. 205 (e) and (f)). This rule requires ingredient disclosure on labels of wine, distilled spirits, and malt beverages. These regulations, however, provide an exception to this requirement. Under this exception the ingredient list will not be required to appear on the label when the producer, bottler, or importer: (1) elects to make an ingredient list available upon request; (2) places a statement on the front label or a separate strip label notifying the consumer of the availability of an ingredient list and provides the name and, somewhere on the label, a full mailing address in the United States where such an ingredient list can be obtained upon request; and (3) does not place a statement on the label which could be misconstrued to be an ingredient list. This exception gives industry maximum flexibility to provide ingredient information at minimum cost. At the same time, it provides consumers who have the need or desire to avoid various ingredients a means to do so, thus meeting the objective of the regulatory proposal. Because of special health problems, this rule also mandates the disclosure on the label, in all instances, of the presence of FD&C Yellow No. 5 whenever it is used in a product.

DATE: October 14, 1980.

FOR FURTHER INFORMATION CONTACT: Norman Blake or Roger Bowling, Research and Regulations Branch, Bureau of Alcohol, Tobacco, and Firearms, Washington, DC 20226, 202-566-7626.

SUPPLEMENTARY INFORMATION:

I. Background

The Department published in the Federal Register on February 2, 1979 (44 FR 6740), a notice of proposed rulemaking entitled "Labeling and Advertising of Wine, Distilled Spirits, and Malt Beverages for Partial Ingredient Labeling" (Notice No. 314). The proposed requirements were intended to assist consumers in identification of ingredients used in wine, distilled spirits, and malt beverages, particularly those consumers who are concerned about possible allergic reactions to certain ingredients. The proposal was developed after one consumer group pointed out that most foods and beverages were required to have all ingredients disclosed on the label and that there were health and consumer reasons to have the same requirements apply to alcoholic beverages.

The 1979 proposed regulations conformed in many instances with food labeling regulations of the Food and Drug Administration and proposals made earlier (Notice No. 271 (40 FR 6349), February 11, 1975; Notice No. 272 (40 FR 6354), February 11, 1975; and Notice No. 149 (39 FR 27812), August 1, 1974) by the Department. Notice No. 314 proposed that all ingredients, except "incidental additives," used in the production of alcoholic beverages be listed on the label of the alcoholic beverage. However, Notice No. 314 proposed important modifications from earlier notices in order to minimize cost burdens on industry. The important modifications were: no order of predominance was required; the list could appear on the front, back, or strip label; under certain conditions ingredients added to adjust natural deficiencies (e.g. sugar in grapes) of essential components need not be listed; producers were allowed to take advantage of seasonal price fluctuations in essential components by listing a range of possible components instead of being required to change the label each time the essential component was changed (shot-gun labeling); the amount of sodium need not be disclosed in parts per million; and the proposal allowed a three-year transition period after final rules were published. Notice No. 314 also required an authorized official of the foreign country of origin to certify that the list of ingredients on imported alcoholic beverages is accurate. Because of requests for extensions, the initial 60-day comment period was extended by 120 days and finally expired on August 3, 1979.

Notice No. 314 raised two basic issues which were addressed by persons providing comments, and by the Treasury in analyzing and acting on the proposal. The first issue was whether alcoholic beverage producers should be required to disclose ingredients used in their products. Is there a need for ingredient disclosure, and is it cost efficient to require this information on every label? The second issue concerned the details of disclosure. For example, should ingredients be listed in the order of predominance, should shot-gun labeling be permitted, and should there be incidental additives/adjuncts which need not be listed?

II. Comments

During the comment period, the Department received 1,873 comments from consumers, special interest groups, industry members, doctors, government agencies and members of Congress. Approximately 75 percent of the comments opposed mandatory ingredient labeling for alcoholic beverages.

Comments in favor: Reasons given favoring the proposal generally indicated that the consumer has a "right to know" what he/she is consuming. Approximately 20 percent of the comments in favor of the proposal gave medical reasons—i.e., an individual who is allergic to ingredients used in alcoholic beverages could avoid those ingredients and thus avoid medical problems. Some also wrote in favor under the belief that a warning label was being proposed and that for religious and personal reasons they were opposed to any type of alcoholic beverages. Members of the malt beverage industry, while suggesting some modifications, generally supported the proposal.

Comments in opposition: Approximately 60 percent of those who opposed said the requirement was too expensive and inflationary; approximately 40 percent said it was unwanted and unjustified; approximately 10 percent said the industry is already too regulated; approximately 20 percent of those opposing the regulations gave personal reasons not related to the proposal (percentages exceed 100 percent since many comments involved more than one area of opposition). Members of the wine and distilled spirits industries were almost unanimous in their opposition to the proposal.

Many industry members, while objecting to the proposal, stated that they either do or would be willing to respond to any inquiries regarding product quality and the ingredients used in their products. One wine industry member commented, "We respond in detail, as I presume most wineries do, to those occasional consumer requests for specific facts. We would certainly pledge our full-cooperation toward a mandated program of that nature."

III. Regulatory Analysis

Executive Order 12044 requires that a Regulatory Analysis be prepared on all regulations whose processing began after May 22, 1978, which have a major economic impact on the general economy, and are determined to be a significant regulatory project. Because of the controversy which has accompanied the concept of labeling ingredients on alcoholic beverages, the Treasury Department decided to conduct a Regulatory Analysis even though it was not required to do so by Executive Order 12044.

As a first step in the Regulatory Analysis, the Department prepared an outline of the analysis which included nine possible alternative ways of dealing with the problems. These alternatives were:

(1) No regulatory action; (2) Public educational programs—joint Department-industry effort where the Government would print pamphlets of general information and instruct interested persons to write producers, bottlers, or importers for specific product information; (3) Ingredient labeling, functional (additives/adjuncts), example: artificially colored, artificially flavored, preservatives added; (4) Ingredient labeling, additives/adjuncts only, no incidental additives/adjuncts;

(5) Ingredient labeling, shot-gun listing of essential components and listing additives/adjuncts, but not incidental additives/adjuncts (as proposed in Notice No. 314); (6) Ingredient labeling, shot-gun listing of essential components and a listing of all additives/adjuncts; (7) Ingredient labeling, listing the essential components and additives/adjuncts, excluding additives found naturally in the essential components; (8) Ingredient labeling, listing the essential components and additives/adjuncts; and (9) Ingredient labeling, listing essential components and additives/adjuncts by order of predominance.

A copy of the full outline for the Regulatory Analysis is available for review at ATF Public Reading Room, Room 4408, 1200 Pennsylvania Avenue, NW., Washington, DC 20226.

ORC Consumer Poll

As a second step in the Regulatory Analysis, the Department decided to utilize an independent means to assist us in assessing whether consumers wanted ingredient labeling and wanted it enough to be willing to pay for the information. The Department selected a private specialized firm, the Opinion Research Corporation (ORC) of Princeton, New Jersey, to conduct a public opinion poll. The ORC survey was a telephone interview among a sample of 2,027 adults. The sample group was reflective of the demographic characteristics (sex, race, age, geographical region, income, and education) in the U.S. population.

The key findings of the survey as reported by ORC are:

1. About 6 drinkers in 10 (61%) believe listing ingredients on alcoholic beverage labels is at least somewhat necessary. Women are more likely to consider an ingredient listing necessary than men.

2. On the average, about one-third of the drinking public say they are unwilling to pay for ingredient labeling for alcoholic beverages and one-third had no opinion. Of the one-third of the drinkers who said they were willing to pay, more were willing to pay for ingredient labeling on a fifth of liquor (an average of 13.2 cents) than for labeling on a bottle of wine (12.5 cents) or a six-pack of beer (9.4 cents).

3. Almost 4 drinkers in 10 (39%) believe the Government's requirement of safe ingredients is sufficient. Thirty-six percent would also like ingredient labeling. 12 percent said they would like some other informational program; and 13 percent were not sure or did not know.

4. A majority of the drinking public (52%) say they usually or always use ingredient lists on packaged food products to compare different brands of the same product. Women (66%) are more likely to claim usage of such ingredient listings than are men (40%).

5. A majority of the drinkers (52%) say they probably or definitely would use ingredient lists on alcoholic beverage products. Again, women (59%) claim they would be more likely to use the lists than men (46%).

BDM Cost/Benefit Study

As the third step in the Regulatory Analysis the Department undertook a cost/benefit study. In order to have an independent assessment of the potential economic consequences of implementing partial ingredient labeling and the specific benefits that might accrue to society, the Department commissioned the BDM Corporation, McLean, Virginia, to study the costs and benefits for all the nine alternative approaches. The Department instructed BDM to analyze on the benefit side both the health costs and the consumer's desire to know and willingness to pay for the knowledge; and on the cost side to analyze what it would cost industry to implement the various options, specifying those costs to be passed on to consumers and the distribution of costs by size of producer.

The Department's conclusions as to the reasonableness of the cost and benefit estimates are given in the next section. The major findings of the BDM study are described below:

1. There are important unanswered questions for both costs and benefits which according to BDM can "lead to widely different conclusions on the desirability of ingredient labeling."

2. Estimates of expected costs of mandated ingredient labeling to industry and the Government based on the information submitted, range between a low of $12 million per year to almost $150 million per year. The major factors that contribute to this range of estimates are the use of a back label, advertisement costs, and mark-ups that might be applied by the industry at different points in the distribution channel. The "advertisement costs"

were submitted directly to BDM by one winery after the comment period and from this one submission BDM estimated a total annual $25 million advertising cost for the entire wine industry.

3. Start-up costs amount to approximately $18 million for the entire industry if no additional back labels are used; if additional back labels are used by all producers not presently using back labels, the "total potential investment cost for the three industries, as reported by the industries, are in excess of $35 million."

4. BDM found "strong evidence" in the medical research literature that indicated "ingredients used in alcoholic beverages can cause adverse health effects in humans." BDM found that while most of the effects are not necessarily severe, some are severe. The study also reports that adverse effects are "not limited to allergic reactions." It is impossible, however, to determine exactly either how many people are affected (the range BDM gave is anywhere from 475,000 to 1,700,000) or how much money in health costs could be saved if ingredients were listed. (A wide range of estimates ranging from approximately one-half million dollars to four hundred million dollars was considered possible, depending on which assumptions were considered the most appropriate.)

5. The data on the extent to which consumers want ingredient labeling information are contradictory. BDM believed the comments received by the Department underestimated true consumer support and the opinion poll "probably overestimates true support." In an attempt to quantify consumer benefits, BDM suggested using data from the consumer poll in which one assumes that approximately one-third to one-half of the consumers would be willing to pay between $0.50 and $2.00 per year. Using this approach BDM says the consumer benefits range between $31 million and $188 million per year.

6. Because of the "uncertainty" in the data, BDM suggests that policymakers estimate the reasonable ranges for each of the key cost and benefit factors as a means of calculating the cost/benefit ratio. The final chapter in the BDM study outlines the methodology for completing such an analysis.

Conclusions

The Department reached several conclusions from an analysis of the comments received in response to Notice No. 314, data in the ORC Consumer Poll, the BDM study, and discussions with other federal agencies:

1. The costs to the industry of mandated ingredient labeling would not be excessive, especially if compared to the industry's $40 billion dollar annual retail sales. The realistic range of annual costs goes from $12 million to $49 million depending upon whether one includes the cost of adding additional back labels. Many of the producers have indicated that they would implement the regulation by use of a back label. It is questionable whether this should be considered a "cost" of ingredient labeling because it is normally more feasible and less costly to include the required information on the front label. An apparent reason for not doing so may reflect a marketing decision to make the list less prominent. However, we recognize that if producers decide to add a back label the cost of the back label will ultimately be passed on to the consumer in the form of a price increase.

The cost to consumers, however, includes more than just the increased cost to producers in implementing ingredient labeling. The BDM study pointed out that at each level of the distribution system it is likely that sellers will mark-up the increased cost resulting from labeling, rather than merely passing it on. BDM also points out that mark-ups could be considered one of the "benefits" for industry members since mark-ups generate additional revenue. Even though legitimate questions exist as to the appropriateness of industry marking-up the cost of ingredient labeling, rather than merely passing the cost on to consumers, we believe that the decision should reflect the likelihood that mark-up will be a cost to consumers.

Claims made by parts of the wine industry during preparation of the BDM analysis that substantial advertising costs ($25 million annual) should be included as a cost of the regulation have been discounted. The wine industry's annual advertising expenditures are now approximately $100 million, and we did not find any convincing arguments that ingredient labeling would necessitate a 25 percent increase in industry advertising expenditures.

Based upon the above, the most reasonable estimate of costs (in millions) supplied by BDM are as follows:

With Back Label: With mark-up, $87 M; without mark-up, $49 M.

Without Back Label: With mark-up, $21 M; without mark-up, $12 M.

The relevant per unit costs range from .057 cents to .81 cents for a 750 ml bottle of distilled spirits; from .09 cents to .3 cents for a six-pack of 12 oz. cans of beer; and from .2 cents to 2 cents for a 750 ml bottle of wine.

2. Start-up costs are not substantial when compared to annual retail sales.

3. There is evidence that ingredients used in alcoholic beverages can have adverse effects for humans including, but not limited to, allergic reactions. It is impossible, however, to determine exactly either how many people are affected (the range BDM gave is anywhere from 475,000 to 1,700,000) or how much money in health costs could be saved if ingredients were listed. The Department believes the most reasonable estimates ranged from $12.5 million to $50 million a year. However, the Department is aware that BDM based its estimates, not on a completed analysis of potential health problems of the actual ingredients used in alcoholic beverages, but on an estimate derived from using The Task Force on Allergies' estimate of the number of people in the United States that are allergic (35 million), and a series of assumptions (the population and the ingredients in alcoholic beverages), which reduce this number of those who are likely to be allegic to ingredients in alcoholic beverages. While the precise level of harm to consumers cannot be established, the Department believes that consumers who are allergic to certain ingredients generally should be able to find out, whether from the label or some other source, if those ingredients are used in alcoholic beverages so that they can avoid the possibility of adverse reactions if they so choose.

4. There are ambiguous data on the extent to which consumers want ingredient information disclosed on a label. The consumer poll reveals most people want the labeling and say they would use it to determine which brands to purchase; but only one-third say they want to pay for it (one-third say they are not willing to pay and the other one-third did not know). While BDM suggested one could conclude from the ORC Consumer Poll that because some consumers were willing to pay something for ingredient labeling that the range for consumer benefit values should range from $31 million to $188 million. However, we also recognized that an equal number of the persons polled said they were unwilling to pay any additional money, thus raising doubts as to the validity of relying on this data.

5. Claims were made during the comment period that the proposed regulations would act as a non-tariff trade barrier. However, the Department considers that the regulations respond to a health issue and has taken steps to assure that any requirements are equally applicable to both domestic industry and foreign imports. Therefore, the department is proceeding in compliance with its international obligations.

IV. Treasury Decision

The Department is convinced that the disclosure of ingredients used in the production of alcoholic beverages is of real value. This disclosure will provide consumers with adequate information about the identity and quality of the product which will enable a consumer to make an informed choice in the purchasing of alcoholic beverages. However, the department also recognizes the uncertainties existing in the data underlying the health and consumer benefits. It has also considered the general policy of fully minimizing costs to industry and consumers in meeting regulatory objectives. Taking all these factors into consideration, this Treasury decision, while making various changes in response to the comments, adopts the ingredient labeling requirements substantially as proposed in 1979. However, to minimize the costs while still meeting basic policy objectives, producers, bottlers, or importers who elect to make ingredient lists available upon request, notify consumers of this availability, and who avoid implied label statements about ingredients, will not be required to list ingredients on the label. The new rules provide:

Basic Rule: All labels of alcoholic beverages must contain a list of ingredients in the manner specified in these regulations.

Exception: An ingredient list is not required on the label when the bottler or importer elects to furnish the ingredient information directly to the consumer upon request, and a statement in the following language conspicuously appears on the front of the brand label, or on a strip label on the front of the bottle or container: "For Information About The Ingredients In This Product (wine, distilled spirits or malt beverages may be inserted for "product"). Write: *(insert name of addressee and mailing address in the United States with zip code where information is available, unless this address appears elsewhere on the bottle or container).*"

Requests for ingredient information should be responded to in a timely manner. Responses to a consumer request within 30 days would be considered timely.

In order to fall within this exception, no statements (other than mandatory information) may be made on the label which would appear to be a statement of ingredients. For example, if a beer label contains a statement such as "this beer is made from grains, hops and yeast," then the full ingredient list must be stated on the label. This limitation is intended to eliminate the possibility that such partial lists might be interpreted as a complete list of ingredients.

This exception can also be claimed only when the list of ingredients furnished by the bottler or importer contains the same information as would be required to appear on the label under the basic rules. The mailed list may, however, include all the possible additives used in the production of that product because producers may be unable to easily associate each request for information to a particular batch of the product. A shot-gun listing of additives is not allowed on the list of ingredients on the label.

By providing this exception from listing ingredients on the label, consumers will be able to "vote" with their purchasing dollar as to how much information they want on a label, and industry members will have the maximum flexibility to provide ingredient information at minimum cost. At the same time people who have the need or desire to avoid various ingredients will have the capability to do so, thus meeting the objective of this regulatory proposal. The department will carefully monitor the success of this approach after it is implemented to see what changes if any, are required.

V. FD&C Yellow No. 5

The Food and Drug Administration (FDA) published a final rule entitled "FD&C Yellow No. 5: Labeling in Food and Drugs for Human Use", (44 FR 37212, June 26, 1979) which established mandatory label disclosure of FD&C Yellow No. 5 (to be listed as such) when used in products for human use. FDA proposed the effective date of July 1, 1981, for such mandatory disclosure.

One consumer group thought that all artificial colorings should be identified by their "FD&C" name, such as FD&C Yellow No. 5. The BDM study also discussed health problems associated with FD&C Yellow No. 5.

Since FD&C Yellow No. 5 is used as a coloring material in alcoholic beverages, the Department has decided that such mandatory label disclosure is also required.

This disclosure is required on the label of all alcoholic beverage products in which the coloring material is used, either in the ingredient list, or when there is no list, elsewhere on the label. It must be stated as, "contains FD&C Yellow No. 5," or substantially in a similar form. Other statements, such as "artificially colored," and "certified color added" are not acceptable for declaring the presence of FD&C Yellow No. 5. It must also be stated in the ingredient lists voluntarily furnished by bottlers and importers.

The Department believes this requirement is necessary in light of the ever-increasing medical evidence of allergic type reactions to FD&C Yellow No. 5. This medical evidence was commented upon during the comment period and was also brought out in the Regulatory Analysis conducted by BDM Corporation as a health issue. However, FD&C Yellow No. 5 will remain on FDA's Generally Recognized As Safe (GRAS) list. At present, the requirement to state this coloring material by name applies only to FD&C Yellow No. 5. Additional disclosure of any specific ingredient will be required where FDA requires such disclosure unless the Department determines that this is not warranted for alcoholic beverages.

Although FDA established July 1, 1981, as the mandatory compliance date in their final rule, the Department has extended its mandatory compliance date for the alcoholic beverage industry until January 1, 1983, to allow an approximately equivalent time for alcoholic beverages that FDA afforded to other products and to be commensurate with other mandatory labeling changes effective the same date, and in recognition of the fact that this substance has not been removed from the GRAS list.

VI. Yeast

Notice No. 314 requested comment as to whether yeast should be considered as an essential component or an additive. For the purpose of writing Notice No. 314 yeast was considered as an additive until the question was resolved.

One wine industry member's comment stated that yeast should be considered neither as an essential component *nor* an additive since wild yeast is found naturally *on* grapes. The member further stated that most producers treat this wild yeast with sulfur dioxide, destroying it, and then add a pure strain of similar yeast for the fermentation process.

One beer industry member's comment stated that yeast is essential to fermentation but is completely removed after the fermentation process and, therefore, listing yeast is inaccurate.

One liquor industry member's comment stated it would be misleading to the consumer to require labeling of yeast as an ingredient when this item is not present in the final product. It is most appropriately viewed as a processing aid or incidental additive.

Historically, the general Government regulation policy regarding labeling of foods and beverages has been that yeast is unique to the process of production and should be listed on a label whenever used.

As stated in Notice No. 314, a key factor in ascertaining whether a substance is an essential ingredient is a determination of whether the substance is fundamental to the production of alcoholic beverages. The Department concludes that yeast is a fundamental ingredient and is an integral part of the production process of wine, distilled spirits, and beer. Therefore, the yeast added is essential to fermentation and should be considered as an essential component in the production of alcoholic beverages. Also, no arguments on this issue were presented which would justify treating the labeling of alcoholic beverages any differently than food products.

VII. Water

Notice No. 314 proposed the requirement to list water as an essential component due to its unique property of being fundamental to the production of alcoholic beverages. Some comments received opposed defining water as an essential component.

One wine industry member's comment stated that in actual practice in California, water is used for the rinsing of machinery during crushing. The commenter concluded that water is not fundamental to the production of wine, and therefore, water should be considered an incidental additive.

One beer industry member's comment stated that water is essential to the brewing process but the term "brewed" connotes the use of water and obviates the need for a redundant statement of its use. It was further stated that to suggest water is an ingredient could be misleading and may imply dilution of the product.

The Department recognizes that water holds a unique position in the production of any alcoholic beverage and concludes that water used in the normal production of alcoholic beverages to facilitate brewing, distilling, or fermenting is essential to the finished product. However, water need not be listed if it is used in insignificant amounts such as for rinsing or washing machinery (crushers, etc.) or facilitating processing aids.

VIII. Incidental Additives/Adjuncts

Notice No. 314 raised the issue of whether there should be a universal standard for determining when an additive/adjunct is too small in amount to be significant, and thus considered incidental.

One industry member's comment stated that "rules of reason" should be used and no arbitrary standards should be established. Various industry comments identified or attempted to justify why a particular additive should not be required to be labeled, however, no comments offered a method to establish universal cut-off standards.

The Department concludes that a list of arbitrary cut-off points is not in the best interest of either consumers or industry. The establishment of cut-off points could be interpreted as the Department's endorsement of a "safe" level remaining in the finished product.

Food and beverage regulations have long recognized that there are ingredients used in insignificant amounts which should be exempt from labeling requirements. They are considered as incidental. The basis for determining whether an ingredient is subject to or exempt from labeling is generally in line with "rules of reason." or the intended function of the ingredient rather than a cut-off point for measuring the presence of residual material.

Under these final regulations three areas are provided under which an ingredient can be considered as incidental.

1. Processing aids that are added to an alcoholic beverage for mechanical effect only and subsequently removed or reduced to a level too small to be significant may be considered incidental. This would include, but not be limited to inert filter aids, most clarifying agents, and fining agents.

2. Processing aids which are added to react chemically or biologically within the product only to remove other substances (as by forming an insoluble compound), and where both the original substances and all the reaction properties are removed or reduced to a level too small to be significant, and have no further technical or functional effect on the finished product, may also be considered incidental.

3. Finally, a processing aid which is added to adjust the natural deficiencies of a constituent part of an essential component may be considered as incidental if the amount added is limited so that the total does not exceed the total quantity normally found in the constituent of that essential component. For example, if a producer adds a sugar or acid of the same type as is normally found in the grape type so that the total amount of the sugar or acid is no greater than that normally found in the grape type it need not be listed. However, if a producer adds a different type of sugar or acid whose make-up is different than that which is normally found in the grape type, the sugar or acid must be listed. If at any time the producer adds a quantity of sugar or acid which is greater than that found normally in the grape type it must be listed.

The provision for adjusting natural deficiencies was slightly modified by deleting "before or during fermentation" to allow flexibility in production. The Department agrees with the wine industry member's comment that this distinction is artificial since acids added after fermentation must be listed, but the same acid added before or during fermentation would not.

The Department, in its Notice No. 314 also proposed that, "a processing aid used in an intermediate product, if it has no technical or functional effect on the finished product (such as sulfur dioxide used to preserve apple juice, which, when the apple juice is added to finish the wine, the sulfur dioxide is not present in the finished wine in sufficient quantity to preserve it)," would be considered as incidental. The Department has reconsidered its position, in an effort to provide consistency in our regulations and meaningful information to the consumer, and will require the disclosure of additives/adjuncts used in intermediate products as would be required under these regulations as an additive/adjunct.

IX. Certification of Imported Products

Notice No. 314 proposed that an official of the exporting country and an official of each foreign country where processing would occur certify to the accuracy of the ingredient lists of the imported alcoholic beverages, as a way of assuring consumers would receive reliable ingredient information on those imported products. The Department formulated this procedure in a manner intended to establish equal responsibilities for domestic and foreign producers in providing consumers reliable information. The Department in the 1979 notice requested specific comments to assist in identifying and evaluating alternative procedures that would improve on the procedure proposed.

Numerous comments were submitted on the certification subject, but none presented suggestions for alternate procedures. The only argument advanced was that the proposed procedure was impractical for foreign producers because it was too harsh (the claim of importers) and unfair for domestic producers because it was too lenient (the claim of the domestic industry).

In the absence of any suggestion for a viable alternative that would insure equal treatment to domestic and foreign producers, the Department is implementing the certification procedures generally as proposed, except, the Department deleted the provisions for a certified list of ingredients from each foreign country where blending or treating occurred. The responsibility for certifying a complete list of ingredients will rest with an authorized government official of the foreign country in which the alcoholic beverage is bottled or packed prior to entry into U.S. Customs custody, thereby reducing the burden of certification on all but the country in which the product is bottled or packed. In addition, a U.S. bottler or producer who subsequently bottles, processes, or packages any imported beverage must provide a certified list of the ingredients in the imported product as part of any application for a certificate of label approval. The authorized government official of the foreign country in which the alcoholic beverage was produced or where additional processing last occurred prior to entry into U.S. Customs custody will sign this certified list of ingredients.

The Department made other modifications to the certification provisions as a result of changes to other sections of the proposal. These changes provide additional latitude that the Department considers comensurate with requirements for domestic producers. At the option of the foreign producer or domestic importer, imported alcoholic beverages must be labeled with an ingredient list or an option statement and address in the United States where consumers may obtain ingredient information. Further, if the ingredient list is not shown on the bottle or container, the option statement must be on either the brand label or on a strip label on the front of the bottle or container. The use of a strip label minimizes the number of labels required by a foreign producer who makes worldwide distribution, thereby saving considerable expense.

In addition, Notice No. 314 proposed that a certified ingredient list accompany applications for certificates of label approval covering malt beverages produced from imported nonalcoholic wort or wort concentrate. The Department is withdrawing this proposal.

X. Order of Predominance

Notice No. 314 proposed that ingredients were not required to be listed in order of predominance. Comments received from consumers and consumer groups objected to this exemption on the basis that it denied the consumer "an approximate idea as to the relative amounts of ingredients" in the product and may be misleading. These same comments stated that if the order of predominance is not shown, this fact should be so stated. The Department concurs with the latter comment that if the ingredients are not listed in order of predominance, a statement "Not Necessarily In Order of Predominance" shall accompany the listing of ingredients. This additional requirement has been included in the final regulations.

XI. Type Style and Size

Notice No. 314 discussed type size, placement of an ingredient list on the label, authorized or required functional statements for additives, and the style of script or print. With the exception of the style of script or print, the other areas have been slightly modified. The notice proposed an effective date of January 1, 1980, for conversion to metric type sizes in Part 5 (Distilled Spirits) and Part 7 (Malt Beverages). However, the Department has extended the mandatory compliance date until January 1, 1983, to be commensurate with other mandatory labeling changes effective the same date.

In addition to conversion from gothic to metric type sizes, Notice No. 314 proposed the ingredient list be in type or printing not smaller than 2 millimeters except the proposal allowed 1 millimeter on certain small container sizes. The Department has reviewed its position and has concluded that the 2 millimeter type size requirement for larger containers and 1 millimeter type size requirement for small containers would dominate an abnormally large area of label space. This would likely contribute to forcing some producers to use a back label for disclosure of ingredients, thus increasing the cost to producers and ultimately, consumers. Therefore, the type or printing for ingredient lists shall not be smaller than 1 millimeter, except the type or printing on certain small bottles shall not be smaller than one-half millimeter.

The placement of the ingredient list on the bottle or container is expanded to include the cap of the bottle or top of the container, provided other mandatory information is not obscured.

Notice No. 314 proposed that preservatives contain a mandatory functional statement, "to preserve" or "as a preservative." This requirement for a mandatory functional statement is changed to be optional.

XII. Derivatives

Notice No. 314 proposed that derivatives be listed separately from their essential components.

One comment from the distilled spirits industry stated that spirits made from corn or a derivative (corn grits or corn meal) are identical and breaking them out separately may mislead the consumer. The same argument was also posed for labeling grapes or grape concentrate.

In the production of any alcoholic beverage, essential components, other than water, are subjected to some initial processing which changes them from their primary agricultural state. For example, corn is ground into corn grits or corn meal and grapes are crushed into grape juice before brewing or fermentation begins.

In response to industry and consumer comments the Department concludes that derivatives of essential components need not be labeled as such unless some other processing affects the composition of the essential component.

XIII. Compounded Essential Components

A comment from the brewing industry stated a 1975 survey conducted by the United States Brewers Association, Inc. demonstrated that listing corn syrup as an ingredient could be misleading to consumers. A significant number of those surveyed thought malt beverages produced from corn syrup would be sweeter than other brands.

While the Department concluded that the distinction between some essential components and their derivatives is unwarranted, that distinction does not hold for those essential components subjected to some other processing affecting their composition.

Corn syrup has long had a standard of identity that allows the addition of ingredients other than corn (preservatives and/or other additives) which distinguishes this product from other derivatives.

The Department, therefore, concludes that essential components which have been compounded by addition of other ingredients should be labeled by listing the commonly recognized or usual name such as corn syrup, or each individual ingredient in that compounded essential component. Producers will then be able to clearly inform consumers of ingredients used in a product by furnishing the well-known name of the ingredient or a truthful and accurate listing of its composition.

XIV. Miscellaneous Amendments and Considerations

If necessary, the Department will consider proposing amendments to other regulations affected by this final rule.

The Department will also give careful and expeditious consideration to all petitions pertaining to matters and changes affected by this Treasury decision.

Transition Period

Notice No. 314 proposed a 3 year transition period. However, due to the extension of the comment period (120 days), the time required to complete the Regulatory Analysis, and the fact that the wine industry is required to make label changes effectively January 1, 1983, the transition period will be slightly less than originally proposed. the Department believes this length of time for the transition period is sufficient for industry to make changes necessary to conform to the new regulations and to make certain that compliance is monitored in the simplest and least burdensome way possible.

Public Inspection and Disclosure

Copies of the final rule, of the Regulatory Analysis, and of all written comments will be available for public inspection under authority of 27 CFR 71.41(b) during normal business hours at the following location: Public Reading Room, Room 4408, Federal Building, 12th and Pennsylvania Avenue NW., Washington, DC 20226.

If a copy of the Regulatory Analysis and the Opinion Research Corporation Survey (Poll) is desired, it can be obtained, for a fee, from: The Office of Disclosure, Bureau of Alcohol, Tobacco and Firearms, Room 5207, 12th and Pennsylvania Avenue NW., Washington, DC 20226.

Drafting Information

The principal authors of these regulations are Norman Blake and Roger Bowling, Research and Regulations Branch, Bureau of Alcohol, Tobacco and Firearms. However, personnel from other offices in the Treasury Department substantially participated in developing the substance and style of these regulations.

Authority

Accordingly, under the authority contained in section 5 of the Federal Alcohol Administration Act (49 Stat. 981 (as amended; 27 U.S.C. 205)), 27 CFR Parts 4, 5, and 7 are amended as follows:

PART 4—LABELING AND ADVERTISING OF WINE

Paragraph 1. The table of sections in 27 CFR Part 4, Subpart D is amended to include an additional section as follows:

Subpart D—Labeling Requirements for Wine

Sec.

* * * * *

4.37a List of ingredients.

* * * * *

Par. 2. Section 4.10 is amended to add, in alphabetical order, the terms "Additive," "Artificial flavor or artificial flavoring," "Essential component," "Incidental additive," "Ingredient," and "Natural flavor or natural flavoring." The added definitions read as follows:

§ 4.10 Meaning of terms.

* * * * *

Additive. For purposes of this part, an additive is any substance, except essential components and incidental additives, added by any means during the production, storage, or treatment of wine and remains in the finished product. For example, substances added to clarify, filter, stabilize, preserve, flavor, or color wine that remain in the finished product are considered additives. Agriculturally identified substances (grapes or yeast for example) which are essential components in the production of the basic wine are not considered additives.

* * * * *

Artificial flavor or artificial flavoring. Artificial flavors or artificial flavoring materials are any flavoring materials not included in the definition of "Natural flavors" in this part.

* * * * *

Essential component. For purposes of this part, an essential component is any agriculturally identified substance (grapes, peaches, blackberries, or yeast for example), used in the production of a basic wine which is fundamental to the production of the wine. Water is specifically included as an essential component.

* * * * *

Incidental additive. (1) A processing aid that is added to a wine for its mechanical effect only (such as an inert filter aid or certain clarifying agents) and is then removed or reduced to a level too small to be significant; or (2) a processing aid which reacts chemically or biologically within the product only to remove other substances (as by forming an insoluble compound) and both the original substance and all of its reaction products are then removed, or reduced to a level too small to be significant, and have no further technical or functional effect on the finished product; or (3) a processing aid which is added to adjust the natural deficiencies of a constituent part of an essential component if the amount added is limited so the total does not exceed the total quantity normally found in the essential component. Any substance which causes, catalyzes, or otherwise participates in a chemical or biological reaction within the product, except as noted in items (2) and (3) of this paragraph, is specifically excluded from this definition of an incidental additive and is considered as an additive.

Ingredient. For purposes of this part, an ingredient is any essential component or additive, except an incidental additive, used in the production of a finished wine.

* * * * *

Natural flavor or natural flavoring. The term "natural flavor" or "natural flavoring" means the essential oils, oleoresin, essence or extractive, hydrolysate, distillate, or any product of roasting, maceration, heating or enzymolysis, which contains the flavoring constituents derived from a spice, fruit or fruit juice, vegetable or vegetable juice, edible yeast, herb, bark, bud, root, leaf or similar plant material, meat, seafood, poultry, eggs, dairy products, or fermentation products thereof, whose significant function is flavoring.

* * * * *

Par. 3. Section 4.32 is amended by changing the reference in (a)(4) from "domestic" to "American"; by adding a new paragraph (c); by relettering existing paragraph (c) as (d) and making editorial changes; and by changing the reference in paragraph (a) to (c) and (d).

As amended. § 4.32 (a). (a)(4). (c) and (d) read as follows:

§ 4.32 Mandatory label information.

(a) Except as otherwise provided in paragraphs (c) and (d) of this section. there shall be stated on the brand label:

* * * * *

(4) On blends consisting of foreign and American wines. if any reference to the presence of foreign wine is made. the exact percentage by volume of foreign wine.

* * * * *

(c) Beginning January 1. 1983. a list of ingredients or the option statement and address in the United States where the ingredient information is available shall appear as required by § 4.37a.

(d) The name and address of the importer (when required to be shown) or the American bottler or packer need not appear on the brand label under one of the following conditions:

(1) In the case of imported wine, it appears on any other label affixed to the container.

(2) In the case of wine domestically bottled. the name and address of the person for whom bottled or packed appears on the brand label. *and* the name and address of the bottler. or packer appears on any other label affixed to the container.

Par. 4. A new section. § 4.37a. has been added. in numerical sequence. to read as follows:

§ 4.37a. List of Ingredients. (Not mandatory before January 1, 1983.)

(a) *Ingredients*—(1) *Label disclosure*. There shall be shown on the brand label. back label. on a separate strip label. or on the cap of the bottle or the top of the container a list of all ingredients used in the production or treatment of wine. If applicable. the list of ingredients must contain the statement "Not Necessarily In Order Of Predominance."

(2) *Exception*. The list of ingredients required under paragraph (a)(1) of this section need not appear on the label where the following conditions are met.

(i) The producer. bottler. packer. or importer timely provides a list of ingredients upon request. The list must comply with the requirements for label disclosures. except that the list may include all additives which are sometimes used in the product. Such additives shall be identified by words indicating that they may or may not be present such as "or." "and/or." "contains one or more of the following." Where the American producer. bottler. or packer takes this exception. a list of ingredients to be furnished to consumers shall be submitted as an attachment to the Form 1649 or Form 1649 Supplemental.

ATTACHMENT 2

TABLE IV-3. SUMMARY OF HEALTH EFFECTS FOR INGREDIENTS REVIEWED

INGREDIENT	WHERE AND EXTENT USED			HEALTH PROBLEMS	POPULATION AT RISK	COMMENTS
	WINE	BEER	SPIRITS			
YELLOW NO 5	V.R.	V R	R	HYPERSENSITIVITY ALLERGIC[*] ANIMAL MORTALITY ANIMAL TOXICITY	APPROXIMATELY 100,000	FDA WILL LIKELY REQUIRE FOOD LABELING
WHEAT			M	HYPERSENSITIVITY ALLERGIC PRODUCES LESIONS IN INTESTINE SCHIZOPHRENIA—PROMOTING		MAY BE WIDESPREAD BUT EXACT INFORMATION IS LACKING
YEAST	W	W	W	HYPERSENSITIVY ALLERGIC DENTAL PROBLEMS CIRCULATORY PROBLEMS IN ANIMALS		DIFFERENT SPECIES OF YEASTS APPEAR TO PRODUCE DIFFERENT EFFECTS
EGG WHITE	R/M			HYPERSENSITITY ALLERGIC	APPROXIMATELY 250,000	FREQUENTLY ON LISTS OF TEN ALLERGIC OFFENDERS
SODIUM BISULPHITE	M	R		ANAPHYLAXIS IN HUMANS VARIOUS DISTURBANCES IN EXPERIMENTAL ORGANISMS		ALTHOUGH FEW RESEARCH PAPERS AVAILABLE, THERE IS POTENTIAL FOR ADVERSE HEALTH EFFECTS IN HUMANS
CASEIN	R/M			HYPERSENSITIVITY ALLERGIC CONTRIBUTES TO NITRITE CONTENT CONTRIBUTES CALCIFICATION IN EXPERIMENTAL ANIMALS	APPROXIMATELY 250,000	CASEIN IS MADE BY A PROCESSING PROCEDURE WHICH IS SUSPECTED OF DEVELOPING ADVERSE EFFECTS IN HUMANS
POTASSIUM METASULFITE SODIUM METASULFITE	W	R		BOTH INGREDIENTS ENGENDER ADVERSE PHYSIOLOGICAL REACTIONS IN ANIMALS		FASEB SUGGESTS MONITORING ON CONSUMPTION OF INGREDIENTS
PARABENS		M		HYPERSENSITIVITY ALLERGIC		
RYE			M	HYPERSENSITIVITY ALLERGIC		
SULFUR DIOXIDE	W			HYPERSENSITIVITY ALLERGIC		
CORN		W	W	HYPERSENSITIVITY ALLERGIES FOUND ON SEVERAL LISTS AS COMMON OFFENDERS	LIKE EGG WHITE, CASEIN	
RICE		W		HYPERSENSITIVITY ALLERGIES		
PAPAIN		R, M		HYPERSENSITIVITY ALLERGIES IN WORKERS WITH PAPAIN		PRESUMPTIVE EVIDENCE THAT IT IS ALSO BORNE BY ALCOHOLIC BEVERAGES
MALIC ACID	W	R		SHOWS PHYSIOLOGICAL DISTURBANCES IN ANIMALS		
CHERRY FLAVORING	R		M	SHOWS PHYSIOLOGICAL DISTURBANCES IN ANIMALS		
MALT		W	W	HYPERSENSITIVITY ALLERGIES IN WORKERS WITH MALT		PRESUMPTIVE EVIDENCE THAT IT IS ALSO BORNE BY ALCOHOLIC BEVERAGES
BARLEY		M	W	MINIMAL PHYSIOLOGICAL DISTURBANCES IN HUMANS		

[*] HYPERSENSITIVITY ALLERGIC WILL BE USED AS A SHORT IDENTIFICATION OF THE CLUSTER OF EFFECTS SUCH AS ASTHMA, URTICURIA, ANGIONUROTIC AND HEADACHES

V R – VERY RARELY
R – RARELY
M – MODERATELY
W – WIDELY

ATTACHMENT 3

[From the New York Times, Oct. 31, 1985]

JUDGE ORDERS DISLOSURE OF ALCOHOLIC DRINKS

By **IRVIN MOLOTSKY**

Special to The New York Times

WASHINGTON, Oct. 30—A Federal district judge ruled today that beer, wine and liquor bottles must carry labels listing all ingredients.

The winner in the case was the Center for Science in the Public Interest, a consumer group, which was joined by the State of New York. They had sued the Reagan Administration, which had canceled such a labeling regulation imposed by the Carter Administration.

The decision was issued this afternoon by Judge John H. Pratt. Dot Kester, a spokesman for the Bureau of Alcohol, Tobacco and Firearms, said her agency had not seen the decision and could not say immediately whether it would file an appeal.

A spokesman for the Distilled Spirits Council of the United States, which intervened on the side of the Government, also had no immediate comment.

Reason for Ending Requirement

Miss Kester said, "Our position has been that the regulation was not cost-effective and would not give the kind of information the consumer was looking for."

Bruce Silverglade, legal director of the Center for Science in the Public Interest, said most Americans would be surprised to learn of the ingredients in some beer, wine and liquor.

Fish glue, for example, is used as a clarifying agent in wine. Another clarifying agent in some wines is casein, a milk product, and Mr. Silverglade said that 250,000 Americans were allergic to it and risked reactions, not knowing that it was in the wine.

"Ingredient labeling is an essential public health measure," Mr. Silverglade said. "More than one million Americans are allergic to the clarifying agents used in beer, wine and liquor."

By far the most widely used and potentially dangerous additives, he said, are sulfites, which have been linked to several deaths.

"Anti-oxidants, preservatives, defoaming agents and artificial flavors and colors are used in beer, wine and liquor without ingredient labeling," Mr. Silverglade said. "Ingredients are listed on all other products, including dog food and shampoo. More than a million Americans are at risk and definitely need this information."

Ruling Is Explained

In his decision, Judge Pratt said previous argument had settled several issues.

One, he said, was that Federal food and drug law was intended "to give consumers information to allow them to make decisions that might affect their health." Another was that while "costs are an important consideration," the Reagan Administration could not base its decision to cancel the regulation "primarily on costs to the industry."

Judge Pratt also wrote, "Alcoholic beverage ingredients can cause adverse health effects in sensitive individuals."

In his decision, Judge Pratt chided the Bureau of Alcohol, Tobacco and Firearms, an agency of the Treasury Department, for having "lifted" arguments from previous cases in which the bureau lost.

"We were immediately impressed with a strong feeling of déjà vu and that we had heard most of these supporting contentions before," Judge Pratt wrote. "These impressions turned out to be all too true."

That same language, he said, contributed to his conclusion that the bureau had "a predetermined mindset." Judge Pratt said the bureau had violated the law, had acted in an arbitrary and capricious manner and had abused the discretion provided it by law.

Wine Institute's Position

Joe Harikian, a spokesman for the Wine Institute, which is based in San Francisco, said his organization would have no immediate comment on today's decision, but he restated its previous position.

This included an assertion that "there has been no genuine consumer support for ingredient labeling" and that "the costs of implementing the proposals to consumers, producers and governments would be excessive and inflationary."

ATTACHMENT 4

MEMORANDUM FROM JOSEPH P. HILE, PUBLIC HEALTH SERVICE, DEPARTMENT OF HEALTH AND HUMAN SERVICES

Date JUL 29 1983

From Associate Commissioner for Regulatory Affairs (HFC-1)
Food and Drug Administration

Subject Informal Comments on Notice No. 469

To Tom George
Chief, Division of Regulations and Procedures
Bureau of Alcohol, Tobacco and Firearms

It has come to our attention that the Bureau of Alcohol, Tobacco and Firearms (ATF) published a notice of proposed rulemaking to reconsider its ingredient labeling regulation for wine, distilled spirits, and malt beverages. The ATF notice, which appears in the Federal Register of June 17, 1983 (48 FR 27782), includes statements that relate to Food and Drug Administration (FDA) regulations and we are offering the following informal comments on the proposal.

The first issue that is discussed in the ATF notice involves "consumer's informed choice." Included in that discussion is the following statement: "Third, unlike foods governed by statutory ingredient labeling requirements, alcoholic beverages are not consumed for nutritional purposes." While it is true that the Federal Food, Drug, and Cosmetic Act (the FD&C Act) generally requires ingredients to be disclosed on packaged foods, neither the FD&C Act nor FDA's regulations on ingredient labeling make any distinction between those foods that are consumed for their nutritional value and the many that are not.

We have also noted that while the ATF notice discusses the "consumer's right to know" issue, there is no discussion about disclosures to facilitate "value comparisons," the basis for FDA's ingredient declaration requirements for cosmetics under the Fair Packaging and Labeling Act (21 CFR 701.3). Indeed, it has been the agency's experience that while, as you point out, there is disagreement about the extent to which consumers want extensive information, most want enough information to be able to make value comparisons, even if only to favor certain ingredients or avoid others.

The second critical issue identified by ATF is the health benefits concern. Included in this discussion is a statement that only a small portion of the population is afflicted with allergies. While we do not know the extent of allergies to ingredients in alcoholic beverages, data derived from a survey of the National Consumer Panel of the Market Research Corporation of America (1977) suggests that approximately sixty-six million adults in the United States believe they have adverse reactions to foods. So far as we know, no reliable estimate is available about the number of individuals who actually suffer adverse reactions from substances in food. Once sensitivity to ingested substances has been confirmed, however, the most effective way of dealing with the problem is to avoid those substances. Because many ingredients may be concealed in prepared products, reliance on ingredient declaration may be the only practicable means for consumers to avoid offending substances.

FDA's continuing experience with the issues involving sulfiting agents clearly indicates that many consumers are especially concerned about possible allergic reactions to these ingredients. Indeed, the letters that we have received from consumers frequently request that sulfites be either prohibited or specifically identified on the products which contain them. Among the letters that FDA has received from consumers are several that specifically comment on sulfites in alcoholic beverages. We are attaching them for your consideration.

Although the reference in your notice to D&C Yellow No. 5 is included under the discussion of public participation, it is also relevant to the issue of health consequences. FDA has determined that there is enough reason for concern about possible adverse reactions to FD&C Yellow No. 5 to require its specific identification on the labels of all foods in which it is used (21 CFR 74.705)

The next key issue identified by ATF relates to costs. One means of reducing costs that FDA has found with food labeling is to allow labelers sufficient time to use up old labels before any new requirements go into effect.

The last issue addressed by ATF in the June 17, 1983, notice relates to the "address label option." On this issue we simply note that FDA has long believed that ingredient information is most useful, particularly to people who are concerned about allergic reactions, if the information is available at the time of purchase.

We appreciate this opportunity to provide these informal comments on your proposal and hope that our comments and the attachments provide useful information.

Joseph P. Hile

Attachments

ATTACHMENT 5

NATIONAL ATTITUDES TOWARD A POTENTIAL EDUCATION CAMPAIGN FOR MODERATE AND SENSIBLE DRINKING HABITS

OCTOBER 1982

Support for Calorie and Ingredient Labelling

About six respondents in ten (61%) said "there should be a federal regulation requiring alcoholic beverage containers to list calories and ingredients." But only one in twenty (5%) believed such a requirement would reduce drinking in the United States "very much." About one in five (21%) believed a labelling requirement might reduce drinking at least "somewhat."

These questions were worded in the following manner:

> "Do you believe there should be a federal regulation requiring beverage containers to list calories and ingredients?"
>
> "Whether or not you approve, how much do you think listing calories and ingredients in alcoholic beverages might reduce drinking in the United States?"

TABLE 9: ATTITUDES TOWARDS CALORIE AND INGREDIENT LABELLING

Should be a federal regulation requiring beverage containers to list calories and ingredients	Total Respondents
	%
Yes	61
No	31
No opinion	8
	100
Would reduce drinking in U.S.	
Very much	5
Somewhat	16
Very little	36
Not at all	38
No opinion	5
	100

Base: 1,039 interview

ATTACHMENT 6

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CENTER FOR SCIENCE IN THE)
PUBLIC INTEREST, et al.,)
)
Plaintiffs,)
)
v.)
)
DEPARTMENT OF THE TREASURY,) Civil Action No. 84-2079
et al.,)
Defendants,)
and)
)
DISTILLED SPIRITS COUNCIL OF)
THE UNITED STATES, INC.,)
Intervenor Defendant.)

FILED
OCT 30 1985
CLERK, U.S. DISTRICT COURT
DISTRICT OF COLUMBIA

MEMORANDUM OPINION

Background

This is the second time that this matter is before us. In the earlier proceeding we set aside Treasury's issuance of T.D. ATF-94 which rescinded certain alcoholic beverage ingredient disclosure regulations embodied in T.D. ATF-66, 45 Fed. Reg. 40,538 (1980). At the same time we ordered the reinstatement of the rescinded regulations.[1] Defendants appealed our decision, but on October 6, 1983, three weeks prior to argument before the United States Court of Appeals for this Circuit, the Treasury's Bureau of Alcohol, Tobacco and Firearms (BATF) issued T.D. ATF-150, 43 Fed. Reg. 45,549 (1983), which again rescinded the Ingredient Disclosure Rule. With the case in this posture, the appellate court dismissed as moot Treasury's appeal from that portion of our order which mandated an effective date for the reinstatement of T.D. ATF-66. At the same time, it dismissed the appeals of two intervenors, the Wine Institute and the Distilled Spirits Council of the United States, which were directed at overturning this Court's decision on the merits.[2] In so doing, the Court of Appeals, speaking through Judge MacKinnon, refused to vacate the merits of our decision, but "let it stand as it is." CSPI-II, 727 F.2d at 1166. It expressed no opinion "as to any preclusive effect following from the district court decision," which it stated should be left, in the first instance, to the court presiding over the new case. CSPI-II, 727 F.2d at 1166 n.5.

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[1] Center for Science in the Pub. Interest v. Department of the Treasury, 573 F. Supp. 1168 (D.D.C. 1983). Plaintiff is hereafter referred to as "CSPI" and this decision as "CSPI-I".

Present Case

In the present litigation, plaintiffs challenge the validity of T.D. ATF-150 by which the Treasury has attempted again to rescind T.D. ATF-66. Plaintiffs, as in the prior litigation, contend primarily that the BATF's rescission violates the Federal Alcohol Administration Act, 27 U.S.C. § 205(e)(FAA Act), and is arbitrary and capricious and an abuse of discretion in violation of the Administrative Procedure Act, 5 U.S.C. § 706(2)(a) (APA). In addition, they assert that since this second attempt to rescind the Ingredient Disclosure Rule raises a substantial number of identical issues previously before this court in CSPI-I, this court should be free to give its prior opinion in CSPI-I "whatever preclusive effort it deserves, should certain issues turn out to be identical. Judicial efficiency may be served in that manner." CSPI-II, 727 F.2d at 1168 n.6. Plaintiffs also argue that in applying the arbitrary and capricious standard, heightened scrutiny of agency action is appropriate here (1) because this case is one where the agency "arrives at substantially the same conclusion as an order previously remanded by the same court," Greyhound Corp. v. Interstate Commerce Comm'n, 668 F.2d 1354, 1358 (D.C. Cir. 1981), and (2) because it involves the health and well-being of the public. Defendants vigorously contest plaintiffs' contentions. All parties have filed dispositive motions and the matter has been fully briefed.

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[2] CSPI v. Regan, 727 F.2d 1161 (D.C. Cir. 1984). This decision is hereafter referred to as CSPI-II.

This Court's Decision in Vacating T.D. ATF-94

In CSPI-I, we covered the statutory authority contained in the FAA Act, 27 U.S.C. § 201 et seq. (1976), for Treasury's regulation of alcoholic beverages, and pertinent portions of the legislative history setting forth the congressional intent behind the enactment of § 205(e). CSPI-I, 727 F.2d at 1169-70. We will not repeat or expand on what we have previously stated. We also set forth the administrative history of the disclosure regulations which were proposed and published in 1979 and which led to the issuance of T.D. ATF-66 on June 13, 1980, as well as its rescission on November 6, 1981, through the promulgation of T.D. ATF-94. CSPI-I, 727 F.2d at 1170-72. Again, we will not replow this ground, except to repeat that the review and rescission of T.D. ATF-66 were purportedly prompted by the issuance on February 17, 1981, of Executive Order No. 12291, 46 Fed. Reg. 13,193 (1981), as a consequence of which the Treasury concluded that T.D. ATF-66 was not cost effective. CSPI-I, 727 F.2d at 1174-75. In brief, we vacated T.D. ATF-94 for the specific reasons therein stated and, to the extent that such reasons are applicable herein, we assert them again.

Standard of Review

In CSPI-I, we set forth the reasons in favor of a heightened standard of review of the challenged agency action, i.e., because the public health was implicated and because the case involved a rescission of previous agency action taken slightly more than a year before. Since our decision, the Supreme Court in Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 41 (1983) (the "air bag" case), has held that the rescission of any agency rule is subject to the same standard of review as the promulgation of the rule, i.e., whether the agency action is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." Plaintiffs would distinguish the holding in State Farm and argue that heightened scrutiny should be the standard, not because T.D. ATF-150 rescinded a previous rule, but because BATF reached a substantially similar result as was previously set aside by this Court and because of the importance of the public health issues raised by the case. While we agree with plaintiffs' contention that State Farm is distinguishable[3] and also with plaintiffs' general formulation, we do not regard this issue as dispositive since we reach the same result irrespective of the standard of review employed.

Issue Preclusion

As previously stated, the Court of Appeals, in deciding not to vacate the merits of this Court's decision in CSPI-I and letting it stand, left this court to determine, what, if any, preclusive effect our prior decision was to have. The Distilled Spirits Council (Council) argues that the decision should be given no prior effect against it, since it was not a party, as well as for other reasons, and because the issues in the present case are not identical. Council's Opposition to Plaintiffs' Motion for Summary Judgment, pp. 9-10. As for defendant Council not being a party, this argument is irrelevant because, as an intervenor, it takes the record as it finds it and is bound by all prior adjudications. United States v. Board of School Comm'rs of Indianapolis, Ind., 466 F.2d 573, 576 (7th Cir. 1972).

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[3] The Supreme Court, while holding that the Court of Appeals was correct in finding that the arbitrary and capricious test "applied to rescissions of prior agency regulations" stated that the court had "erred in intensifying the scope of its review based upon its reading of legislative events." State Farm, 463 U.S. at 44.

After careful consideration of T.D. ATF-66 (the original Ingredient Disclosure Rule), T.D. ATF-94 (the first rescission invalidated in CSPI-I) and T.D. ATF-150 (the second rescission, the validity of which is before us for review), we determine that a substantial number of the same issues of law and fact are implicated. These include the following:

1. One purpose of § 205(e) of the FAA Act, while a consumer's statute in the narrow sense, is to give consumers information to allow them to make decisions that might affect their health. CSPI-I, 573 F. Supp. at 1174.

2. While costs are an important consideration, rescission of the Ingredient Disclosure Rule may not be based primarily on costs to the industry. CSPI-I, 573 F. Supp. at 1176-77.

3. Alcoholic beverage ingredients can cause adverse health effects in sensitive individuals. CSPI-I, 573 F. Supp. at 1177-78.

4. BTAF improperly relied on FDA approval of ingredients as a reason for rescinding the Ingredient Disclosure Rule. CSPI-I, 573 F. Supp. at 1177-78.

5. BTAF improperly relied on FDA's standards of indentity for alcoholic beverages as a basis for rescinding the Ingredient Disclosure Rule because standards of indentity do not provide consumers with adequate information about ingredients. CSPI-I, 573 F. Supp. at 1177-78.

All of the foregoing issues have already been decided in the prior litigation, and we give them preclusive effect.

Analysis

T.D. ATF-66 issued June 13, 1980, had its roots in many sources. Aside from a petition filed as early as 1972 by plaintiff CSPI, one of these sources was the Food and Drug

Administration (FDA) which, having important responsibilities bearing on the public health, was concerned about adverse reactions to certain alcoholic beverage ingredients.[4] Commissioner Donald Kennedy of the FDA had expressed these concerns when he testified before the Congress in 1978. See Alcohol Labeling and Fetal Alcohol Syndrome, Hearings on S. 1464 before the Subcomm. on Alcoholism and Drug Abuse of the Senate Comm. on Labor and Human Resources, 95th Cong., 2nd Sess. 10 (1978). Although not required to do so, the BATF, as a preliminary matter, conducted a Regulatory Analysis which set forth nine alternative ways of dealing with the problems. 45 Fed. Reg. 40,539 (1980).

Pursuant to this Regulatory Analysis, the Treasury engaged the services of the BDM Corporation, an independent consultant. The BDM study is the only in-depth attempt sponsored by the Treasury to consider the costs and benefits for all nine alternative approaches. The BDM study directed its attention to the matter of health hazards, examined consumer need, and weighed the cost of ingredient disclosure. There is no other comparable study in the present record.

The Treasury, as a further step in its Regulatory Analysis, utilized another independent consultant, the Opinion Research Corporation of Princeton, New Jersey (Gallup) to conduct a consumer poll to assess whether consumers wanted ingredient labeling and wanted it enough to pay for this information.

After considering the results of the BDM study and the Gallup Poll, and after taking into account various uncertainties, it reached a decision to require that a list of basic ingredients and additives be set forth on alcoholic beverage labels. Under certain conditions, it gave manufacturers the option of placing a notice on the label informing consumers where to write for ingredient information (address label option).

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[4] FDA had previously attempted to issue regulations on this subject but was prevented from doing so as a result of a suit brought by intervenor Council and other industry members. Brown-Forman Distillers Corp. v. Mathews, 435 F. Supp. 5 (W.D.Ky. 1976). The court held that BATF has exclusive jurisdiction over alcoholic beverage labeling. Id. at 17.

As finally enacted, the Ingredient Disclosure Rule was a compromise. Only the amount of information which would be useful to consumers and at the same time not be unduly burdensome to the industry was required to be disclosed on the label. Incidental additives, defined as those used or present in insignificant amounts, were exempted. Finding that the requirement could withstand cost benefit analysis, its decision to issue was grounded on factors of health and the needs of consumers for such protection. 45 Fed. Reg. 40,540 (1980). Despite its thorough and thoughtful treatment of a complex subject, it was shortly to be overturned.

In early 1981, soon after the present administration came into office, the BATF sharply reversed its prior position and proposed to rescind the recently promulgated Rule. It emphasized that under Executive Order No. 12291, all regulations were required to be cost beneficial. On November 9, 1981, the BATF issued T.D. ATF-94, rescinding the Ingredient Disclosure Rule. In so doing, it concluded, inter alia, that "the ingredient labeling regulations would result in increased costs to the consumer and burdens on the industry which are not commensurate with the benefits which might flow from the additional label information," that ingredient labeling would not result in an appreciable benefit to consumers, and that existing labeling requirements and standards of identity were sufficient to protect the consumer and ensure product integrity. 46 Fed. Reg. 55,094 (1981). On November 8, 1983, this court invalidated T.D. ATF-94 and ordered reinstatement of the Ingredient Disclosure Rule not later than February 8, 1984. CSPI-I, 573 F. Supp. at 1179. Five months later, BATF, for a second time, has proposed to rescind the Ingredient Disclosure Rule. Following the receipt of comments, BATF on October 6, 1983, issued T.D.

ATF-150, the validity of which is the subject of the present litigation.

T.D. ATF-150 is similar to T.D. ATF-94 in all essential respects except that it requires the disclosure of FD&C Yellow Dye No. 5, a color additive, the inclusion of which plaintiff had long advocated. As to other ingredients, it agreed to consider the necessity of mandatory labeling on a case-by-case basis in further rulemaking proceedings upon the basis of which it purportedly can make an informed decision. The BATF no longer attempts to rely on the alleged disadvantage to our international commitments caused by the increased requirements. Though going into somewhat greater detail, the reasons advanced in support of T.D. ATF-150 are basically the same as those underlying T.D. ATF-94, i.e., the costs are disproportionately high when compared with the benefits to be derived and consumers are adequately protected under the existing regulations. 48 Fed. Reg. 27,783 (1983). It particularly states that there is "neither evidence of a substantial consumer interest in the legislation nor clear evidence that the information would provide substantially useful information to consumers generally. . . ." 48 Fed. Reg. 45,555 (1983). In attempting to explain its conclusions so contrary to those of T.D. ATF-66, it contends that its findings "are not as different from those in 1980 as it might appear" because in T.D. ATF-66 the Department recognized the uncertainties of the data concerning "health and consumer benefits" and was concerned about "these uncertainties and the costs" of mandating labeling. 48 Fed. Reg. 45,555 (1983). It states that many of the conclusions of T.D. ATF-66 were unwise and, while within the zone of legitimate discretion, further asserts that upon reconsideration "a different decision is preferable and within the zone of discretion under the FAA Act." 48 Fed. Reg. 45,556 (1983).

A careful comparison of T.D. ATF-150 with T.D. ATF-94 compels the conclusion that BATF has adopted essentially the same rationale which this court rejected in CSPI-I. More specifically, it ignores certain of the most significant evidence of record, including the Gallup consumer poll showing consumer preferences, the BDM study, and FDA's consistent support of ingredient labeling,[5] as well as the published medical literature. Its references to FDA's standards of identity as providing adequate protection to consumers is contrary to our findings in CSPI-I and attempts to raise issues which are precluded. Furthermore, T.D. ATF-150, as did T.D. ATF-94, again places improper reliance on considerations of cost in violation of the FAA Act. This is shown when it discounts the availability of the address label option to provide a "painless and inexpensive" form of ingredient disclosure. 48 Fed. Reg. 45,555 (1983). This is further reflected in its decision to include the labeling of FD&C Yellow Dye No. 5 since, because it would be used on only a few products, "the cost would not be substantial in comparison with the demonstrated benefit. . . ." 48 Fed. Reg 45,554 (1983). In fact, the entire fabric of T.D. ATF-150 is permeated with attention to matters of cost.

On reading T.D. ATF-150, we were immediately impressed with a strong feeling of *deja vu* and that we had heard most of these supporting contentions before. This impression turned out to be all too true. Not only did the BATF employ the same arguments to support its original rescission in T.D. ATF-94 but, in the preamble, it frequently adopted the *verbatim* or substantially *verbatim* language found in the briefs of the Treasury and the intervenor previously submitted to this court in CSPI-I and long before "new" comments were received and considered by BATF. In its treatment of subjects designated "Consumers' Informed Choice," "Health Benefits," and "Costs", the unidentified authors of T.D. ATF-150 have simply "lifted" large portions from the earlier briefs as the following will graphically show:

---

[5] While the FDA did not directly comment on the first rescission, its position as early as 1978 was a matter of public record. *See supra* p. 7. In the rulemaking proceeding which antedated the issuance of T.D. ATF-150, it did file a comment in favor of ingredient labeling. Letter of Joseph P. Hile, Associate Commissioner of Regulatory Affairs, FDA to BATF (July 20, 1983).

Subject	Total Length in Lines	Lines Taken from Prior Briefs	%
Consumers Informed Choice	212	77.5	36%
Health Benefits	144	64	44%
Costs	195	123	63%

Furthermore, this wholesale appropriation has taken place without any attribution as to the real sources of this material or any indication of the fact that it had been previously submitted in support of action which we invalidated in CSPI-I.

Conclusion

Based on all of the foregoing, we conclude that T.D. ATF-150 represents a predetermined "mindset" to reinstate a previous position which was held unlawful. It fails to provide a "reasoned explanation" for its second attempt to reverse the policies underlying the issuance of T.D. ATF-66. In its reliance on issues precluded by our decision in CSPI-I, T.D. ATF-150 has asserted again many of the same considerations which we considered and held to be invalid. As in the case of T.D. ATF-94 the BATF has again violated the FAA Act and without adequate support in the record, has taken action which is arbitrary, capricious, and an abuse of discretion in violation of the APA.

An order consistent with the foregoing has been entered this day.

J. H. Pratt

John H. Pratt
United States District Judge

Date: 30 october 85

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CENTER FOR SCIENCE IN THE
PUBLIC INTEREST, et al.,

Plaintiffs,

v.

DEPARTMENT OF THE TREASURY,
et al.,

Defendants,

and

DISTILLED SPIRITS COUNCIL OF
THE UNITED STATES, INC.,

Intervenor Defendant.

Civil Action No. 84-2079

FILED
OCT 30 1985
CLERK, U.S. DISTRICT COURT
DISTRICT OF COLUMBIA

ORDER

Upon consideration of the parties' cross-motions for summary judgment, the memoranda, affidavits and other papers filed, and the entire record herein, it is by the court this 30th day of October, 1985,

ORDERED that plaintiffs' motion be and the same hereby is granted, and it is

ORDERED that the final rule contained in T.D. ATF-150 and issued by the Department of the Treasury on October 6, 1983, 48 Fed. Reg. 45,549, is vacated; and it is

FURTHER ORDERED that within thirty (30) days of the date of this order the Department shall announce the new date upon which T.D. ATF-66 will be mandatory, the new date not to be any later than six (6) months from the date of this order.

J.H. Pratt
John H. Pratt
United States District Judge

ATTACHMENT 7

ALCOHOLIC BEVERAGE INGREDIENT LABELING

"GOOD MORNING AMERICA TRANSCRIPT" - FEBRUARY 7, 1986

ANNOUNCER: John Stossel continues his series of special reports with a look at what you might not know you're drinking.

(DEPICTIONS OF ALCOHOLIC BEVERAGES)

JOHN STOSSEL (J.S.): How would you like to quench your thirst with some cold, foamy propylene glycol alginate? No? Well then, how about some delicious sulfer dioxide with dinner? Or a touch of dipotassium phosphate after your meal? I hate to say it, but some of your favorite -- and my favorite -- drinks have additives in them you probably don't know about. It's hard to find out about them because none of this stuff's labeled. You know, it's funny, because almost everything else is. Soft drinks are. Even dog food is labeled. So why not alcoholic drinks? Well, the main reason is that it's regulated by a different government agency. The FDA handles food, the Bureau of Alcohol, Tobacco, and Firearms regulates drinks. It currently doesn't feel labeling is necessary. The beer, wine, and liquor industries certainly agree with that. They cite trade secrets. They say it will cost too much. And they say there's no need. They say people are not getting sick or dying from chemicals in drinks. I asked a proponent of labling about that.

BRUCE SILVERGLADE, CSPI: People are dying. For example, a person died just last July from sulfiting agents in wine. In the mid-1960's about twenty persons died from cobalt sulfate, which was used as a foam enhancer in beer.

J.S.: Why do they say people are not being hurt by this?

B.S.: Well, they may as well be saying the earth is flat. They have been denying the truth for about ten years.

J.S.: Why do you think they resist?

B.S.: They fear the truth. For marketing reasons, they want to keep consumers in the dark, so that they can pass off what are essentially chemical concoctions as pure and natural beverages. But it just ain't so.

JOHN DE LUCA: That's not correct. It's not a chemical concoction.

J.S.: John DeLuca is President of the Wine Institute.

J.D.: We believe that wine is the fermented juice of ripe, sound grapes.

J.S.: He has a point. And not just about wine. Beer is also mostly natural. It's made with water, yeast, malted barley, and hops. However, some manufacturers do add chemicals to control the color, how high the foam will go, how long the foam will last. And I was surprised to find an article in the magazine Food Engineering that shows how Miles Laboratories, the people who Alka-Seltzer, have found a way to substitute enzymes for the more expensive natural malt. "Brew-Enzyme" they call it. They won't say which beer companies they're selling it to. Hard liquor is probably the freest of additives. Usually its just alcohol distilled from grain, yeast, and water. [It's] the fancier stuff, the liqueurs, the pre-mixed cocktails that contain the most additives. "Cream", for example, is a tricky word. Bailey's uses real cream. Hublein spells it "C-R-E-M-E" and uses non-dairy chemicals. And food dyes are used in some liqueurs. Mmm, nothing like a blue drink. And chemical companies advertise to wine makers, too. So why not just label these things? We don't know how many people are allergic. Why not just put the ingredients on the bottle so those people would know. We'll look at that and check into which ingredients might give you an allergic reaction right after this. (COMMERCIAL BREAK)

ANNOUNCER: Here's John Stossel again to tell us some manufacturers don't mind telling us what we're drinking.

J.S.: The beer industry is the least opposed to labeling. Says the Center for Science, that's because they have the least to hide. The liquor and wine industries are more opposed. They say labeling would be misleading. For example, the distillers lobbyists told us, "If we make vodka from corn, we might have to put 'corn' on the label. That would make people think they're getting nutritional benefit from vodka, and that's misleading." The industry's main argument is that millions of people have been drinking liquor and wine for thousands of years without getting sick. Labeling would just frighten them.

J.D.: Because it would lead to the misleading notion that in drinking wine you are drinking a concoction that has been made up of different elements, a little bit of this and a little bit of that added up all together equals wine.

J.S.: But if it isn't made up of these chemical concoctions --

J.D.: Yes...

J.S.: --then why not just say so on the label?

J.D.: Because we believe that it would be misleading to the consumer. Why have government involvement unless you have a real confirmation that there is a real health issue involved?

J.S.: He says there's no health issue. But remember sulfites? The F.D.A. plans to ban them in salad bars because many asthmatics and some other people have severe reactions. Wine makers add sulfite to keep the wine from fermenting further once it's in the bottle. But the industry says its sulfites are chemically different, so they're not likely to cause reactions. They won't convince Lois Franklin of Fort Collins, Colorado. She's an asthmatic, and some asthmatics are unusually sensitive to sulfites. What happens?

LOIS FRANKLIN: I drink wine, as soon as I would have the slightest sip, I would start choking, and get itchy and scratchy, and it goes into a very severe attack.

J.S.: "Severe attack" meaning...

L.F.: That I can't breathe. It cuts off the airways. I've had actual trips to the hospital and it's so frightening. I can't even talk by the time I get there; someone, of course, has to take me, and they have to give me adrenaline right away.

J.S.: She even had to stop taking communion wine in church. That little makes her sick. We know of one sulfite-sensitive man who died after drinking wine. Daniel Tsevat was a 32-year-old Dallas man. One afternoon last July, after sipping some wine, he started choking, lost consciousness, and by the time he got to the hospital, he was dead.

J.D.: Without me being a coroner or... We asked our doctors to look up that report. The individual involved was a very sick person, with incredible asthmatic hypersensitivity. And...--

J.S.: Well, these are the people we're talking about.

J.D.: Yes... Yes. The probability here, according to our doctors, is not high at all. To put it on a label with a health scare implication implies that there's something intrinsically wrong with the product.

J.S.: The debate continues. The various parties are now fighting it out in the courts. Meanwhile, what can you do if you have an allergy? Well, you could write the government agency that regulates the manufacturers; they have the information. However, they won't give it out. It would violate trade secrets, they say. They suggest you write the companies themselves. We tried that, we wrote fourteen saying, "I'm a consumer who's allergic to some additives. Would you tell me what's in your products?" Some companies were very responsive. Taylor Wine, for example, listed everything, including the scary-sounding stuff. So did Stroh's Beer. Anheuser-Busch, Genessee Beer, and Coors sent us a list. However these companies didn't answer our letter at all, and it's been a month already. [COMPANY NAMES SHOWN: Brown-Foreman Distillers; Ernest and Julio Gallo Wines; Glenmore Distillers; Christian Brothers Wines; National Distilleries; Seagrams Wines; Pabst.] And one company responded, but didn't tell the whole truth. Almaden said its chablis is made "just from wine grapes." They didn't say it includes sulfites, though it does. We called Almaden. They said they meant to mention sulfites, they just sent us the wrong letter. Finally, you should know that some companies are labeling ingredients voluntarily. Anheuser-Busch, for example -- three cheers for them. They label Michelob, Bud, and their other beers. You drink those products, you know exactly what you're drinking.

ATTACHMENT 8

[From the Los Angeles Times, Dec. 2, 1985]

WHAT'S IN THE BOTTLE?

Federal food and drug laws make it clear that consumers should have information that helps them make decisions affecting their health. But consumers at the beer, wine and liquor counter are still denied information about alcoholic-beverage ingredients to which they could be allergic or that could cause other health problems. The House will vote this week on a measure that could prolong that unhealthy ignorance.

The Center for Science in the Public Interest, a Washington-based nonprofit group that concentrates on food and nutrition, has compiled a list of ingredients about which it feels the public should know. For example, the wine industry uses sulfur dioxide to kill bacteria on grapes, to stop fermentation and to preserve the wine. But thousands of Americans, especially those who suffer from asthma, may be particularly sensitive to sulfur dioxide, as well as to sodium bisulfite and potassium metabisulfite, which are preservatives that are used in wine. The yeast used in fermenting beer, wine and spirits causes problems for some people, as does the corn in beer and in some liquor.

Twice the Treasury Department's Bureau of Alcohol, Tobacco and Firearms has issued a rule that manufacturers must either list the ingredients on the labels or tell consumers on the labels where to write for information. Twice the department has rescinded its rule, and now twice a federal district court has ruled in favor of labeling.

This week the House will vote on a measure that would deny the Treasury Department the money to enforce this rule until all appeals are exhausted. In its last decision, on Oct. 31, the court said, "Alcoholic-beverage ingredients can cause adverse health effects in sensitive individuals." The House should buy this round for them.

ATTACHMENT 9

CHEMICAL ADDITIVES IN BOOZE

II. Calorie Content of Alcoholic Beverages

Regular Beers	Calories*** (12 oz. servings)	Alcohol Content*** (By Volume)
1. Michelob	168 *	4.9%
2. Schmidt	165	4.8
3. Black Horse Ale	162	5.0
4. Knickerbocker	160	4.6
5. Rheingold	160	4.6
6. Budweiser	156	4.9
7. Busch Bavarian	156	4.9
8. Miller	150 **	
9. Eastside Lager	145	
10. Buckeye	144	4.6
11. DuBois Beer	144 *	
12. Utica	144 *	
13. Meister Brau Premium	144	4.6
14. Schmidt (low alcohol)	142	3.2
15. Black Label	140	
16. Burgie!	140 *	
17. Pabst	140 *	
18. Tuborg	140	4.8
19. Budweiser (low alcohol)	137	3.9
20. Busch Bavarian (low alcohol)	137	3.9
21. Pearl	136 *	
22. Heidelberg	133	4.6
23. Stroh Bohemian (low alcohol)	126	3.2
AVERAGE: (excluding lows)	149	4.75

Light Beers	Calories** (12 oz. servings)	Alcohol Content** (By Volume)
1. Michelob Light	134	4.1%
2. Red, White, Blue (Pabst)	119	3.6
3. Stroh Light	115	4.1
4. Budweiser Light	108	3.5
5. Gablinger's Extra Light	99 ***	4.5
6. Black Label Light	96	4.1
7. Iron City Light	96	4.2
8. Erie Light	96	4.1
9. Meister Brau Lite	96 ***	4.6
10. Miller Lite	96	4.2
11. Schlitz Light	96	3.6
12. Schmidt Light	96	4.1
13. Steg Light (Stegmaier)	96	3.9
14. Ultra Light (DuBois)	96	4.2
15. Utica Light	96	4.1
16. Amstel Light (Holland)	96	3.7
17. Burgie! Light Golden	70	2.9
18. Pabst Extra Light	70	2.4
19. Pearl Light	68	2.8
AVERAGE:	97	3.7

*Calculated from information given on brewer's light beer.

**As indicated on container or obtained from the manufacturer.

***From *Calories and Carbohydrates*, 4th revised edition by Barbara Kraus. © 1971, 1973, 1975 by Barbara Kraus, © 1979, 1981 by the New American Library. Reprinted by arrangement with the New American Library, Inc., New York, N.Y.

Liquor (by proof) gin, rum, vodka, whiskey	**Calories†** **(1 1/2 oz. = 1 jigger portions)**
100	124
94	116
90	110
86	105
80	97

Table Wines **(4 oz. portions)**	**Calories††**
Sparkling Burgundy	115
Sweet Sauterne	110
Dry Red	85
Dry Rosé	82
Dry White	80
"Light" White	60

Aperitif & Dessert Wines	**Calories††**
Sweet Vermouth (3 oz.)	135
Kosher (2 oz.)	130
Dry Vermouth (3 oz.)	100
Port (2 oz.)	100
Sweet Sherry (2 oz.)	95
Dry Sherry (2 oz.)	80

†Data from USDA Agriculture Handbook No. 456.

††Used by permission from D.J. Forkner. "The Professional Nutritionist" Spring. 1982.

ATTACHMENT 10

CENTER FOR SCIENCE IN THE PUBLIC INTEREST

PETITION TO AMEND ALCOHOLIC BEVERAGE LABELING REGULATIONS TO PROVIDE INFORMATION REGARDING CALORIE CONTENT

The undersigned submit this petition pursuant to the Administrative Procedure Act, 5 U.S.C. §551 et seq.; and Section 71.41(c) of Title 27 of the Code of Federal Regulations. Petitioners request the Director of the Bureau of Alcohol, Tobacco and Firearms ("BATF") to issue regulations to require the calorie content of all alcoholic beverages to be listed on the label or container of each product, and to take other appropriate measures to insure that this information is provided in a clear, non-misleading manner.

INTRODUCTION

Alcoholic beverages--beer, wine and distilled spirits--contain signicant levels of calories and can contribute to obesity, a problem of concern to millions of consumers. Yet, calorie-conscious consumers find it difficult, if not impossible, to determine the calorie content of alcoholic beverages because current regulations do not require that calorie information be listed on all container labels. At this time, BATF regulations require only manufacturers of "light" (low-calorie) beverages to list calorie information on labels.

The range of calorie content in different brands of alcoholic beverages is great. Beer contains 70-170 calories per 12 ounces, a glass of wine between 60-135 calories, and a jigger of liquor 95-125 calories. [1] Furthermore, the variation in calorie content of different brands of so-called "light" alcoholic beverages is similarly great. Hence, the term "light" confuses and misleads consumers. For example, light beers contain between sixty-eight and one hundred and thirty-four calories.[2] At least one light beer appears to provide more calories than a competitor's regular brand. Brand-to-brand variations in calorie content information make informed purchasing decisions virtually impossible.

I. CALORIE LABELING OF ALL ALCOHOLIC BEVERAGES SHOULD BE REQUIRED BY BATF TO PROVIDE CONSUMERS WITH ADEQUATE INFORMATION ABOUT THE PRODUCTS THEY MAY PURCHASE.

A. Alcoholic beverages contribute significantly to the problem of obesity.

Eighty million Americans are clinically overweight. [3] Alcoholic beverages, which are rich in calories but have little nutritional value, contribute significantly to calorie intake and obesity for many Americans. Obesity can be a killer disease, as well as a serious psychological and social problem. Obese people face a greater than average likelihood of developing diabetes, hypertension and heart disease.

In 1980, the average American consumed approximately two gallons of distilled spirits, two gallons of wine and twenty-four gallons of beer. [4] Furthermore, alcoholic beverage consumption is increasing. Average consumption for all persons older than fourteen is thirty percent higher than fifteen years ago. [5] These figures mean that today the American population consumes more than ten trillion calories (50,000 calories per person) each year in the form of alcoholic beverages.

Calories consumed in the form of alcoholic beverages mean that alcohol provides between five and six percent of the average daily calorie intake for every man, woman and child in the United States. Obviously, the figure is much higher for the drinking portion of the public. One survey indicates that thirty percent of the drinking population consumes eighty percent of the alcohol consumed annually. This same survey also reveals that ten percent of the drinking population consumes fifty percent of the alcohol. [6]

When alcoholic beverage consumption is viewed in light of these figures, it is no wonder that a panel of the White House Conference on Food, Nutrition and Health in 1969 concluded that

> By virtue of the dilution effect of their nutritionally empty calories alcohol containing beverages can disrupt the balance of essential food factors to total calories, to harmful levels. [7]

The panel also stated the following as one of its objectives:

> To educate those who drink to compensate nutritionally for their empty calories that they get in significant amounts by the consumption of even so-called socially acceptable amounts of alcoholic beverages. [8]

The Conference panel formally recommended that appropriate federal agencies disseminate information to the lay public informing them of the potential of alcohol to disrupt the calorie and nutrition qualities of their diets. [9]

In addition, the Nutrition Foundation, an organization sponsored by the food industry, recommended, in its 1966 publication entitled Obesity, that people should avoid excess amounts of alcohol. [10] The Foundation further cautioned that for someone trying to diet, "[a]lcoholic drinks, of course, are a hazard." [11] The Foundation's words of warning are more important today than they were seventeen years ago given the fact that per capita consumption of alcoholic beverages has been rising steadily since the mid-1960's. [12]

B. Consumer demand for calorie content information is very high.

Millions of Americans are extraordinarily concerned about obesity. According to one newspaper account, the public spends $10 billion annually on diet books, pills and other aids. [13] Such statistics indicate that consumers are hungry for information that may assist them in the battle of the bulge. Calorie labeling will be an obvious benefit to weight-conscious people, and will help reduce the incidence of obesity in America today.

In a recent Gallup poll, 62% of respondents said they favored a regultion requiring labels on alcoholic beverages to disclose calories as well as ingredients. [14] Furthermore, in a 1979 FDA study of citizen comments on food labeling, sixty-two percent of the majority of the commenters who used nutritional information labeling chose calorie content as the most important piece of information that could be provided. [15] In addition, an FDA sponsored Consumer Food Labeling Survey, conducted in 1978, concluded that consumers ranked the provision of calorie content information as the highest priority food label revision that they desired. [16].

Consumers are even willing to incur higher prices for products containing nutritional information. The Food and Drug Administration undertook a survey of consumers' nutrition knowledge in 1975. One measure of shoppers' attitudes towards nutrition labeling was obtained by asking them if they would be willing to pay extra (up to fifty cents each week) so that this information could be put on food products. Two-thirds of those surveyed were willing to pay at least ten cents more each week for nutritional labeling.

In spite of this very high demand for calorie information, the vast majority of alcoholic beverages do not contain this vital information. Under currently proposed regulations, BATF would only require calorie information for "light" products. Given the strong consumer demand for such information, BATF should exercise its authority to require all alcoholic beverages to provide calorie information.

Armed with the additional information that calorie labeling would provide, consumers would be able to make wiser and more informed purchasing decisions. At the very least, consumers would be reminded that alcoholic beverages contain significant numbers of calories. Those consumers who choose to limit their daily or weekly calorie intake from alcoholic beverages would be able to buy low-calorie varieties. Those consumers who had previously assumed that all beers or wines or mixed drinks contained "about" the same number of calories would have the opportunity to switch to lower calorie brands if they so choose. The end result would certainly be a better-informed, and perhaps slimmer, alcoholic beverage-consuming public.

C. The costs of calorie content labeling are minimal.

Though the exact costs to industry of complying with the calorie content rule are not available, a comparison to the anticipated compliance costs of other proposed label modifications indicates that the cost of adding a simple declaration of calorie content would be minimal.

The cost-benefit study of BATF's rescinded Ingredient Labeling Rule concluded that if the additional information was provided on existing labels, "industry costs could be relatively small." [17] Common sense indicates that a calorie disclosure would cost much less than ingredient disclosure, because less chemical analysis would be required and because the calorie content of beverages remains virtually constant during production.

In another study, A.D. Little, Inc. calculated the economic impact of an FDA proposal to require food labels to note that ingredients are listed in descending order of predominance by weight. Industry compliance would have resulted in passed-on costs to consumers raising the price of food a maximum of seven-hundredths of one percent if the requirement were phased in over a two-year period. [18] The cost of such labeling initiatives is undoubtedly much less, as the cost estimates in this study were based in part on data supplied by the food industry, which generally opposes such proposals. Compliance costs to the alcoholic beverage industry would probably be less, but certainly no more, than the estimated costs of the FDA proposal.

D. BATF should implement its statutory mandate to protect consumer health by requiring calorie content information on alcoholic beverage labels.

BATF's statutory mandate is the Federal Alcohol Administration Act, 27 U.S.C. §201 et seq. ("FAA Act"). The FAA Act provides a comprehensive scheme for federal regulation of the alcoholic beverage industry. One of Congress' goals, in enacting the FAA Act, was to require that alcoholic beverage manufacturers provide consumers with information that would inform them about the identity and quality of alcoholic beverages. Consequently, Section 205(e)(2) of the FAA Act specifically assigned responsibility to the Administrator (now the Director of BATF) to issue regulations for alcoholic beverage labels "as will provide the consumer with adequate information as to the identity of the products." 27 U.S.C. §205(e)(2). Calorie content is precisely the kind of helpful information that consumers want and that BATF should require under Section 205(e)(2). [19]

The legislative history of Section 205(e)(2) makes it clear that Congress' chief concern was to provide consumers with complete label information about the content of alcoholic beverages. The following statement made by the director of the then Federal Alcohol Control Administration is of particular relevance to the purpose of Section 205(e)(2):

> Those regulations were intended to insure that the purchaser should get what he thought he was getting, that representations both in labels and in advertising should be honest and straightforward and truthful. They should not be confined, as the pure food regulations have been confined, to prohibitions of falsity, but they should also provide for the information of the consumer, that he should be told what was in the bottle, and all the important factors which were of interest to him about what was in the bottle [emphasis added]. Hearings on H.R. 8539 Before the House Comm. on Ways and Means, 74th Cong., 1st Sess. (1935).

BATF's statutory mandate to protect consumer health by requiring that specific information appear on wine, beer and liquor labels has been recognized by the courts. In Center for Science in the Public Interest v. Dept. of the Treasury (No. 82-0612, D.D.C., February 9, 1983), the court stated that the clear purpose of the FAA Act, 27 U.S.C. §205(e), was to provide consumers with information to allow them to make decisions that might affect their health, slip op. at p. 9. Similarly, in Wawszkiewicz v. Department of the Treasury, 480 F.Supp. 739 (D.D.C. 1979), rev'd, in part, on other grounds, 670 F.2d 296 (1981), the court stated that the FAA Act called for regulatory provisions which will provide adequate information as to the identity and quality of alcoholic beverages, 480 F. Supp. at 745.

Alcoholic beverages contribute greatly to the problem of obesity in America, and consumer demand for calorie information is high. Accordingly, BATF should require calorie labeling on all alcoholic beverages. [20]

II. EXISTING REGULATIONS FOR "LIGHT" ALCOHOLIC BEVERAGES PERMIT DECEPTIVE AND MISLEADING LABELING PRACTICES.

A. Variations in the calorie content of "light" beverages deceive consumers.

Current BATF policy, and regulations proposed in the Federal Register, 45 Fed. Reg. 83530 (1980), both fail to set specifications for the calorie content of "light" alcoholic beverages. Among light beers, for example, the calorie content can vary almost two-fold, from a low of 68 calories (Pearl Light) to a high of 134 calories (Michelob Light). With no prescribed range of calories for light beers, the unsuspecting consumer may be misled by the fact that a beer as high in calories as Michelob Light may be called a "light" beer. BATF regulations which permit the industry to define the range of calories in light beverages create consumer deception and are inconsistent with the requirements of Section 205 of the FAA Act.

Furthermore, some light beers may even contain more calories than a competitor's regular beer. For instance, Michelob Light with 134 calories has a higher calorie content than Heidelberg regular beer, which has 133 calories, and Stroh Bohemian (low alcohol), which has 126 calories. Since regular beers are not labelled for calorie content, it is impossible for a consumer to be aware of this discrepancy. The resulting deception to the public must be corrected by BATF in the form of a regulation, which limits the number of calories allowed in "light" alcoholic beverages.

By way of comparison, the Food and Drug Administration has promulgated regulations for low-calorie foods and beverages which minimize the possibility of consumer deception. For example, to minimize confusion concerning the calorie content of certain diet beverages made from nutritive and non-nutritive sweeteners, the FDA requires that such products be formulated so that their caloric value is at least fifty percent less than the caloric value of comparable products made without artificial sweeteners, 21 C.F.R. §100.130(b). Additionally, the label of this product must bear a statement of the caloric content per fluid ounce, 21 C.F.R. §100.130(d)(2).

FDA has also recognized the possibility that consumers may be deceived or misled by labeling that claims or implies that a food may be useful in reducing or maintaining caloric intake or body weight. Therefore, FDA regulations allow a food to be labeled as "low calorie" only if a serving of the food supplies no more than 40 calories, 21 C.F.R. §105.66(c)(i). That same regulation allows a food to be labeled as "reduced calorie" only if a comparison of its calorie content with the calorie content of an equivalent serving of the same food for which it would substitute reveals a calorie reduction of at least one-third, 21 C.F.R. §105.66(d)(i).

FDA regulations governing the labeling of low calorie food and beverages represent a logical effort to minimize consumer deception. Governmental restrictions on the calorie content of low and reduced calorie foods and beverages enable consumers to make more informed purchasing decisions and eliminate the possibility of a "Michelob Light-Heidelberg" situation where the "low calorie" food actually contains more calories than a comparable regular calorie food of a competitor.

Petitioners call on BATF to follow the FDA's lead and limit the number of calories which can be contained in "light" alcoholic beverages. For malted beverages, we recommend that BATF permit "light" beers to contain no more than 100 calories per serving. At the present time the calorie content of most "light beer" is about 100 calories or less per 12 ounce serving. BATF may find this figure a useful starting point for determining an upper limit on calorie content of light beer. A similar survey of "light" wines should be conducted with the aim of setting upper limits on the calorie content of these beverages. In this manner, consumer deception can be prevented.

B. Section 205(e)(1),(4) of the FAA Act requires BATF to modify labeling regulations that engender deceptive or misleading trade practices.

BATF has limited discretion in matters involving misleading or deceptive trade practices. Section 205(e) of the FAA Act requires the Director of BATF to issue regulations for alcoholic beverage labels

> ... (1) as will prohibit deception of the consumer with respect to such products or the quantity thereof and as will prohibit, irrespective of falsity, such statements relative to age, manufacturing processes, analyses, guarantees, and scientific or irrelevant matters as the Secretary of the Treasury finds to be likely to mislead the consumer;... [and] (4) as will prohibit statements on the label that are ... false [or] misleading... 27 U.S.C. §205(e).

The legislative history of Section 205(e) is clear, *supra*, p.g. The purpose of Section 205(e) shows:

> ...*the purpose was to carry that regulation into certain particular fields in which control of interstate commerce in liquors was paramount and necessary* [emphasis added]. Hearings on H.R.8539 Before the House Comm. on Ways and Means, 74th Cong., 1st Sess. (1935) (statement of Joseph H. Choate, Administrator, Federal Alcohol Control Administration).

Thus, Congress chose to limit BATF's discretion, and misleading or deceptive labeling practices must be prohibited.

BATF's statutory mandate to prevent misleading or deceptive labels was also recognized by the D.C. Circuit in *Wawszkiewicz v. Department of the Treasury*, *supra*. [21] In discussing Section 205(e) the circuit court stated that BATF "is directed to prohibit" misleading statements irrespective of falsity, 670 F.2d at 302. BATF may not authorize any deceptive labeling unless it gives sufficient explanation based upon facts in the record, *Id*. at 303. See also, *CSPI v. Dept. of the Treasury*, No. 82-0610, *supra*, *slip op*. at p. 14. Accordingly, BATF must now act to alleviate consumer deception that now results from its current regulatory scheme.

CONCLUSION

A practical solution to providing adequate information to alcoholic beverage consumers is for BATF to implement its statutory mandate, 27 U.S.C §205, and require calorie content to be listed on all alcoholic beverages. This will insure that consumers can make informed choices about competing brands. BATF should take such action in light of the correlation between alcohol consumption and obesity, the strong consumer demand for mandatory calorie information on all foods and beverages, and the minimal cost of such regulations to the industry.

BATF has limited discretion to prevent deceptive and misleading labels. In order to correct the deceptive and misleading consequences of significant brand-to-brand variations in calorie content, BATF must exercise its power to issue regulations that would place an upper limit on the number of calories in "light" alcoholic beverages.

Respectfully submitted,

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Dated: February 28, 1983

Co-Petitioners:

American Nurses Association
American Public Health Association
American Society of Bariatric Physicians
Dr. LeClair Bissell (President, American Society on Alcoholism)
Consumer Federation of America
Center for Science in the Public Interest
Diet Center, Inc.
Diet Workshop, Inc.
National Association for Public Health Policy (Council on Alcohol Policy)
National Federation of Licensed Practical Nurses
National Women's Health Network
Dr. Nathan Pritikin (Longevity Research Center)
U.S. Conference of Local Health Officers

Footnotes

1. Chemical Additives in Booze, Center for Science in the Public Interest, 1982, p. 93-95.

2. Ibid., p. 93-94.

3. Health and Nutrition Examination Survey (HANES), National Center on Health Statistics, August 30, 1979.

4. *Statistical Abstract of the U.S. 1981*, U.S. Census Bureau.

5. *Healthy People*, U.S. Dept. of Health, Education and Welfare (1979), p. 10-12.

6. *The Public Health Approach to Problems Associated with Alcohol Consumption*, National Institute of Alcoholism and Alcohol Abuse, 1981, Chart I-13.

7. *Final Report*, White House Conference on Food, Nutrition and Health, May 6, 1969, p. 57.

8. *Ibid*., p. 57

9. *Ibid*., p. 57

10. *Obesity*, Nutrition Foundation, p. 11, 1966.

11. *Ibid*., p. 14.

12. NIAAA, *supra*, note 6, Chart I-2.

13. New York *Times*, February 24, 1981, p. C1: "What Does a Diet Actually Do?"

14. "Gallup Poll", commissioned by the National Council on Alcoholism, January 20, 1983.

15. 44 *Fed*. *Reg*. 75995 (December 21, 1979).

16. 44 *Fed*. *Reg*. 75995 (December 21, 1979).

17. *Regulatory analysis of partial ingredient labeling of beer, wine and distilled spirits*, BDM Corporation, p. I-4, February 8, 1980.

18. *Economic Impact Analysis of a Declaration that Ingredients are Listed in Descending Order of Predominance*; Final Report to the FDA; HHS Contract No. 223-79-8052; A.D. Little, Inc., May, 1981, p. 231-232.

19. In light of Petitioners admonition to BATF to follow the lead of FDA in preventing deceptive and misleading labels, see *infra* at Section II, it should be noted here that BATF is empowered to correct labels on the grounds of "adequacy", a power which FDA does not have. Thus, BATF has greater authority to require label information than FDA.

20. Petitioners urge BATF to order mandatory, as opposed to voluntary, labeling. Based on past experience, a voluntary effort will not succeed. In March, 1982, the Center for Science in the Public Interest wrote to eighty-six producers of beer, wine and liquor requesting that calorie information be voluntarily labeled. No substantive responses were ever received. Other voluntary labeling programs have been similarly unsuccessful. FDA's vigorous efforts to encourage food manufacturers to voluntarily list sodium information on labels has resulted in only a 6% increase in the number of manufacturers who provide such information. FDA's semi-voluntary nutritional labeling program has led only 40% of food manufacturers to provide such information.

21. *See also*, *Continental Distilling Corp. v. Humphrey*, 247 F.2d 796 (D.C. Cir. 1957), where the court upheld BATF's authority under Section 205(e) to issue label regulations "to aid in preventing deception." 247 F.2d at 797.

ATTACHMENT 11

MEMORANDUM OF MILLER BREWING CO., IN RESPONSE TO ADVANCE NOTICE OF PROPOSED RULEMAKING REGARDING THE ADVERTISING OF MALT BEVERAGES

B. Use of the Terms "Light" and "Light Beer" in the Advertising of Beers Containing More Than 100 Calories, Such as Michelob Light, Is Misleading.

1. A Few Beers, Such as Michelob Light, Are Advertised as "Light Beers" Even Though They Contain More than 100 Calories.

Although several brewers had introduced reduced calorie beers in the 1960's, those beers enjoyed only limited success in regional markets. It was not until Miller spent considerable time, effort and money to develop and market Lite that a reduced calorie beer became popular on a national basis. In 1975, after testing in several areas, Miller began national distribution of Lite. It was an immediate success, and it continues to be the leading seller among all reduced calorie brands.

Other brewers raced to share in Lite's success. They developed new brands patterned after Lite and began marketing what they called "light beers."[4] Many brewers incorporated the word "light" in the brand names of their new beers, frequently taking the name of the brewer's regular beer and simply adding the word "light." Advertising for some of these new brands adopted the term "light beer" to categorize reduced calorie beers, to distinguish them from "regular" or full-calorie beers and to trade on Miller's successful Lite brand.[5]

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[4] For example, during 1975, Jos. Schlitz Brewing Company introduced "Schlitz Light" beer; Blitz Weinhardt of Portland, Oregon introduced "Alta"; and Peter Hand Brewing Company introduced what it labeled "Peter Hand Extra Light." During 1976, G. Heileman Brewing Company introduced a reduced calorie beer promoted as "Premium Light by Heileman." Shortly thereafter, Olympia Brewing Company introduced "Olympia Gold." Anheuser-Busch introduced "Anheuser-Busch Natural Light" in 1977.

The following chart, based on available information from beer labels and product analysis, lists the calorie content and calorie reduction (compared to the brewer's "regular" beer) for reduced calorie beers which have been promoted as "light beers":

BRAND	Calories per 12 ounces	Calorie Reduction
Alta (old product)	96	1/3
Alta (new product)	60	1/2
Anheuser-Busch Natural Light	97	1/3
Brew 96	96	1/3
Coor's Light	110	2/9
Falstaff 96	96	1/3
Gablinger's (Extra Light)	96	1/3
Heileman Light	96	1/3
Hudy Delight [by Hudepohl]	96	1/3
Koch's Light	90	--
Light Lager (Erie)	96	1/3
Lite	96	1/3
Lucky 96	96	1/3
Lucky Lite	68	1/2
Mark V Light Beer	96	1/3
Michelob Light	134	1/5
Narragansett 96	96	1/3
Nine O'Five Light Beer	96	1/3
Olympia Gold	70	1/2
Pabst Extra Light	70	1/2
Pabst Light	100	1/3
Pearl Light	68	1/2
Peter Hand Extra Light	96	1/3
Players	70	1/2
Premimum Light by Heileman	90	1/3
Quittin' Time Light	68	1/2
Rainier Light	96	1/3
Rheingold Extra Light	96 [87] can	[1/3]
Schlitz Light	96	1/3
Schmidt's Light	96	1/3
Stroh's Light	115	2/9
Ultra Light	96	1/3
Utica Club Light	96	1/3

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[5] Shortly after introducing its "Alta" reduced calorie brand, Blitz Weinhardt ran an advertisement which was headlined "New Alta vs. The Other Light Beer." This may have been the earliest advertisement categorizing reduced calorie beer as "light beer."

The beer that most obviously does not fit within the category of beers promoted as "light beer" is Michelob Light, which has by far the highest calorie content of any reduced calorie beer promoted as a "light beer."[6] In fact, each of the regular beer counterparts for all the other so-called "light beers" listed above appears to contain from 140 to 150 calories. AB's most popular regular beer, Budweiser, contains about 145 calories. Thus, Michelob Light has only slightly fewer calories than AB's regular premium beer.

The higher calorie content of Michelob Light may result from the way it is produced. Michelob Light is simply watered-down Michelob. Rather than using a different brewing process -- such as brewers generally use for reduced calorie beers, and AB itself uses for its Natural Light[7] -- we understand that AB produces Michelob Light simply by brewing a batch of regular Michelob and then diluting it with carbonated water. The water is carbonated mechanically by injection of carbon dioxide. We seriously doubt that consumers are aware that the manufacture of Michelob Light consists of little more than pumping carbonated water into Michelob.

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[6] The other listed brands with more than 100 calories were introduced in May and September 1978, following the launching of the Michelob Light brand.

[7] Many brewers, including AB, achieve calorie reduction and the other desired characteristics of reduced calorie beers by the use of enzymes. AB uses malt enzymes in producing Natural Light. Miller uses another standard food enzyme for Lite. Although, in recent publications and elsewhere, AB has sought to disparage Miller's use of this food enzyme, the fact is that the same enyzme is commonly used in the production of canned fruits, ice creams, candies and bakery products. Indeed, the same enzyme is used by AB itself in connection with a number of its patented corn syrup products.

Unquestionably, Michelob Light is substantially higher in calories than any other beer which is advertised as a reduced calorie "light beer." Nevertheless, it is positioned and promoted as if it were in the same category. Not only does the term "light" appear in its name, but the labeling and advertising for Michelob Light make it evident that the word "Light" is designed to convey the impression of reduced calories. Both on labels and in advertising there are specific references to calorie content. The labeling for Michelob Light now bears the statement "contains 134 calories, approximately 20% fewer than Michelob," a phrase prescribed by BATF for reduced calorie beer labels.[8] The television commercials for Michelob Light likewise display print-overs of calorie content and the difference in calories between Michelob Light and Michelob. See Exhibits 1-5.

Thus, although Michelob Light has nearly as many calories as most "regular" beers, it has been masquerading as a "light beer" since its introduction by AB in February 1978. Prior to that introduction, other brewers had spent more than $80 million to establish consumer interest in and demand for reduced calorie beers. It is apparent that, in advertising Michelob Light as a "light beer" even though it has "regular" beer calories, AB has sought to ride the coattails of these expenditures and take unfair advantage of this consumer demand. Moreover, although it has watered down its beer, AB has not reduced the price. Michelob Light is generally priced at the same super-premium level as regular Michelob. We urge the Bureau to take action to halt this calculated deception.

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[8] When first introduced, Michelob Light labels did not reveal the brand's calorie content. Unlike other beers advertised as "light beers", Michelob Light labels still do not disclose the brand's carbohydrate content.

2. The Advertising of a Beer Containing More Than 100 Calories as a "Light Beer" Is Misleading and Deceptive.

In the current market environment, the advertising of Michelob Light, and other beers with more than 100 calories, as "light beers" is misleading and deceptive in violation of the FAA Act. Sections 5(e) and (f) of the FAA Act prohibit any statement in the advertising or labeling of malt beverages which is false and misleading and which is not in conformity with BATF regulations designed to prevent "deception of the consumer" with respect to such products. 27 U.S.C § 205(e), (f). BATF regulations applicable to the advertising of beer prohibit "any statement that is false or misleading in any material particular." 27 C.F.R. § 7.54(a)(1),

Other BATF regulations prohibit malt beverage labeling which contains any statement that is false or untrue in any particular, as well as "[a]ny statement . . . that, irrespective of falsity, directly or by ambiguity, omission, or inference . . . tends to create a misleading impression." 27 C.F.R. § 7.29(a)(1). In addition, no label may contain a brand name that conveys an erroneous impression as to any of the characteristics of the product. 27 C.F.R. § 7.23(b).

The advertising of Michelob Light violates all of these provisions. Michelob Light has attempted to take unfair advantage of the recent popularity of reduced calorie beers through misleading advertising and labeling featuring the term "light."

The use of the name "Michelob Light" and the positioning of that product as a reduced calorie beer is intended to give consumers the false impression that Michelob Light is comparable in calories and caloric reduction to other reduced calorie beers, such as Lite. However, neither its labeling nor advertising discloses that, at 134 calories per twelve-ounce serving, Michelob Light contains far more calories (about 45% more) than most other reduced calorie beers and only slightly fewer calories than regular beers, such as Budweiser.

Michelob Light technically complies with the existing requirements that it display the number of calories per twelve-ounce serving (134) and the reduction in calorie content compared to regular Michelob (20%) on the label and in advertising. But this is manifestly insufficient to advise consumers that Michelob Light is almost as high in calories as most regular beers and substantially higher than any other reduced calorie beer. Michelob Light labeling and advertising gives consumers no reason to suspect that there is a substantial difference in calories between that brand and other brands promoted as "light beers." Only if consumers take the initiative to compare the labels of various so-called "light beers" would this difference become apparent. Other brewers have been powerless to correct the misleading impressions fostered by Anheuser-Busch because they are not permitted under current regulations to compare the caloric content of

Michelob Light with that of their own beers. See Revenue Ruling 76-1, discussed below.

Finally, the Food and Drug Administration has recently promulgated new regulations for labeling low-calorie foods which require, among other things, that any food "that bears representations that it is low or reduced in calories" must have at least 1/3 (33-1/3%) less calories than the same food without the caloric reduction. 21 C.F.R. § 105.66(d)(1)(i), 43 Fed. Reg. 43,259 (September 22, 1978, effective July 1, 1979). Under this test, Michelob Light, which contains only 1/5 (20%) fewer calories that "regular" Michelob, and only about 8% fewer calories than Budweiser, falls far short of the mark.[9/]

In short, the advertising and promotion of Michelob Light as a reduced calorie or "light beer" is misleading and deceptive in violation of the FAA Act and BATF regulations because it creates misleading impressions with respect to a material characteristic -- calorie content. Accordingly, BATF should take immediate steps to halt these unlawful practices, prohibit their recurrence and provide for correction of the misleading impressions which have been given to consumers.

3. BATF Should Issue a Regulation Specifically Prohibiting Use of Terms Such as "Light" in the Advertising of a Beer Containing More than 100 Calories.

Although the promotion of Michelob Light as a reduced calorie beer is misleading and deceptive,

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[9/] The other so-called "light" beers which have more than 100 calories likewise do not pass this test.

current BATF regulations on reduced calorie representations do not focus specifically on the use of the terms "light" and "light beer" in the promotion of such beers. There are now no specific restrictions or guidelines as to what types of beers may be promoted as a reduced calorie beer or advertised as a "light beer." New regulations specifically addressing this issue would prevent further deception such as has occurred with Michelob Light. Such regulations should specify that use of the terms "light" and "light beer" to promote a reduced or low-calorie beer is permitted only if a twelve-ounce serving of the beer contains 100 or fewer calories.

The current restrictions on calorie and carbohydrate representations in beer advertising and labeling are set out in a 1976 BATF statement, Revenue Ruling 76-1. This ruling generally prohibits, with two exceptions, "any labeling or advertising references which indicate or imply the presence of calories or carbohydrates in malt beverage products." As exceptions, the ruling permits only a truthful statement of average analysis and a truthful statement of caloric comparison between the low-calorie product and an equal volume of the brewers' regular beer, such as "96 calories -- approximately 1/3 fewer calories than our regular beer."

The intention of Revenue Ruling 76-1 was to prevent consumer deception with respect to the calorie content of malt beverages. It is obvious from the foregoing, however, that some brewers have violated the spirit, if not the letter, of the existing regulation. The amended regulation proposed by Miller would plug the loopholes in the current regulation and prevent consumer misunderstanding and deception. Specifically, consumers would be assured that beers promoted and purchased as reduced calorie "light beers" are indeed beers with significantly reduced calorie content and no more than 100 calories.

While greatly benefiting the consumer, the proposed new regulation will not involve great costs to the brewing industry. With only a few exceptions, almost all reduced calorie beers already meet the standard of 100 or fewer calories per twelve-ounce serving. A brewer whose beer does not meet the 100 calorie requirement can simply modify advertising and labeling for that beer to avoid use of the misleading term "light beer."[10] Alternatively, the brewer could modify the beer so as to meet the 100 calorie maximum.

An alternative formulation of the amended regulation to parallel the FDA rule -- requiring that a brand advertised as a "light beer" have at least 1/3 fewer calories than the brewer's regular beer -- would, at the present time, have exactly the same effect as the proposed 100 calorie maximum rule. The labels on the three so-called "light beers" which currently have more than 100 calories indicate that those beers do not have as much as a 1/3 reduction in calories. All beers with 100 or fewer calories are now promoted as having at least a 1/3 reduction in calories. However, such a rule could pose substantial problems of enforcement. While the number of calories in a beer is an easily established fact, the identification of the "brewer's regular beer" might be difficult to ascertain in the case of brewers with multiple brands. For example, while AB's Michelob Light has 1/5 fewer calories than Michelob, it has almost the same number of calories as Budweiser, AB's most popular regular beer. It would even be possible for a brewer to create a new, extra-high calorie brand simply for purposes of satisfying the requirement that the beer it wishes to promote as a "light beer" has 1/3 fewer calories. In short, the 100 calorie maximum provides a bright line test which can easily be applied by brewers, regulators and consumers alike.

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[10] Even if BATF has approved particular labeling in the past, BATF can alter its labeling requirements for purposes of preventing consumer deception "notwithstanding loss may be caused individuals who have relied upon a different position previously taken." Continental Distilling Corp. v. Humphrey, 220 F.2d 367, 372 (D.C. Cir. 1975).

ATTACHMENT 12

B. Only Malt Beverages Which Are Truly Low in Calories Should Be Allowed To Be Promoted As Low-Calorie Products.

The Bureau has found that consumers understand the term "light" to be an indication of low or reduced calories. Yet, there continue to be beers on the market, promoted as "light," with calories at about the same level as most "regular" beers. The Bureau's objective to regulate the advertising and packaging of low- or reduced-calorie malt beverages, in order to reduce the deception and confusion of consumers, could best be effectuated by restricting the type of malt beverages that may legitimately be so presented. Specifically, we propose that only those malt beverages which, per 12-ounce container, contain either (i) 100 calories or less or (ii) at least one-third fewer calories than the brewer's corresponding regular brand can properly be deemed low- or reduced-calorie products.

The soundness of this dual test is plain. Almost every malt beverage promoted as a "light" or reduced-calorie product today meets this test.[*/] Accordingly, consumers have come to equate a malt beverage promoted as low in calories as one that has no more than 100 calories or which has at least one-third fewer calories than the brewer's corresponding regular beer. The one-third-fewer-calories test has been adopted by the federal Food and Drug Administration as the governing standard for various foods that are presented as low-calorie products. Plainly, this test is a generally accepted measure of a legitimate reduced-calorie product. There should be no special exemption for malt beverages from the accepted limitations, applicable to foods and beverages in general, as to the amount of calories a food product may contain and still be promoted as low in calories.

As we demonstrated in our prior submission to the

[*/] There are more than thirty products presently on the market that are promoted as low-caloric beverages. Ninety percent of them could meet this proposed test.

Bureau,[*] certain brewers -- most notably Anheuser-Busch in its promotion of Michelob Light -- have exploited consumer perceptions about reduced-calorie malt beverages. A twelve-ounce container of Michelob Light contains 134 calories. This amount, which is substantially higher than the calorie content of any other low-calorie beer, is only slightly lower than the 145 calories in Budweiser, Anheuser-Busch's most popular beer, and less than one-fifth lower than the calories in regular Michelob.

The Bureau's proposed regulations -- which would merely require brewers to disclose on their labels the average analysis of their beer -- would not eliminate the public deception caused by self-proclaimed low-calorie beers that in fact are not low in calories. Both the FTC and the courts have expressly held that the truthful disclosure of actual caloric content on a product label does not cure the consumer deception resulting from a trade name or slogan that falsely represents a food product as being low in calories. *Bakers Franchise Corp.*, 59 F.T.C. 70, 77 (1961), *aff'd*, 302 F.2d 258 (3d Cir. 1962) (Deception arising from use of the term "Lite Diet" bread would not be cured by a statement on label that product is "not low in calories."). *See also Resort Car Rental System, Inc.*, 83 F.T.C. 234, 277-78 (1973), *aff'd*, 518 F.2d 962 (9th Cir. 1973) (Rental car company's trade name "Dollar-A-Day" would be deceptive even with disclaimer in advertising that "no vehicle may be rented for a dollar a day."). Accordingly, the notion that the disclosure of a beer's average analysis will prevent consumers from being deceived with regard to falsely represented low-calorie beers must be considered illusory.

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[*] *See* Miller's March 22, 1979 "Memorandum In Response to Advance Notice of Proposed Rulemaking," 8-26.

Only a product whose caloric content is substantially below that of regular beers may properly be presented to the public as a reduced-calorie product. To permit beverages which do not meet reasonable, objective standards to be promoted as low-calorie products is to permit transparent efforts to exploit consumer trust. The FAA Act prohibits such false and misleading advertising. The 100 calorie or "one-third less" limitations will ensure that only genuine low-calorie products will be so promoted.

PREPARED STATEMENT OF THE DISTILLED SPIRITS COUNCIL

Senator ABDNOR. The subcommittee has received a statement from the Distilled Spirits Council with regard to the Bureau of Alcohol, Tobacco and Firearms. Without objection, it will be placed at this point in the record.

[The statement follows:]

Statement of the Distilled Spirits Council of the United States, Inc.

The Distilled Spirits Council of the United States, Inc. ("DISCUS") represents the manufacturers and importers of approximately 85% of the distilled spirits produced and sold in the United States.

We request that the FY 87 Treasury Appropriations bill carry language contained in prior continuing resolutions and appropriations bills addressing ingredient labeling of alcohol beverages. It is a matter of importance to the distilled spirits industry and to members of the Senate and House who are concerned with elimination or reduction of government waste. When this Subcommittee has addressed the issue in the past, it has correctly expressed the view that ingredient labeling requirements should not be imposed unless and until the litigation of the matter under the Federal Alcohol Administration Act is concluded.

Chairman Abdnor articulated Congressional intent very precisely and cogently:

> "to suspend the ideological tug of war over which way we ought to go on new ingredient labeling requirements until all litigation on the issue is complete. BATF has expended a good deal of its time and scant resources on this question over the past 10 years, going one way under the previous administration and another way under the current one. We just do not think it is good management to pursue the broad ingredient labeling issue until the courts have fully clarified both BATF's jurisdiction and legal obligations under the Federal Alcohol Administration Act." (131 Cong. Rec. 12,106 (daily ed. Sept. 25, 1985))

We believe that it is important for the Subcommittee to continue to express the intent of Congress to prohibit the use of BATF funds to implement the ingredient labeling rule until the litigation is concluded.

1. Cost to the Government.

The United States Court of Appeals for the District of Columbia Circuit currently is considering the result of the latest rulemaking conducted by BATF involving the propriety of ingredient labeling. The appeal is being taken from the District Court's order, dated October 30, 1985, which directed that a previous ingredient labeling rule become mandatory not later than six months from the date of the Court's order. The Court of Appeals has stayed the District Court order pending appeal.

One purpose of the restriction in the Continuing Resolution is to prevent BATF from wasting limited resources to carry out a lower court order until litigation of the issue, including appeals and remands, is completed. It would be wasteful for BATF to expend funds in setting up enforcement mechanisms, and providing extensive guidance to the implementation of a rule full of ambiguity until the litigation is completed. The costs to BATF of implementing the District Court's order would be substantial. The Associate Director of BATF described in an affidavit filed with the District Court in November 1985 the work of the agency's personnel in approving spirits, wine, and beer labels. The task would be considerable and the effort might be entirely wasted.

2. Cost to Industry.

The cost to industry also would be enormous. DISCUS has made careful estimates of the cost of implementing the rule -- separate from the continuing annual cost of compliance.

We estimate that as of December 1985 the cost of implementation would have been $50.96 million for the distilled spirits industry alone. That estimate is for an orderly implementation with at least one year of lead time. The industry would have to redesign thousands of front and back labels, install new equipment or modify old equipment, design and produce new bottle molds, implement numerous new administrative recordkeeping procedures, undertake additional product laboratory analysis, and incur additional labor expenses related to labeling, recordkeeping, and product handling.

When BATF ordered implementation of shotgun ingredient labeling in 1980, it granted a full two and a half year phase-in period. Our cost estimates assume an orderly implementation schedule for the industry of at least twelve months. Any shorter time period would result in substantially higher implementation cost than $50.96 million because: (1) the major overtime expenses which would have had to be paid to personnel working at a crisis pace; (2) the premium which would have to be paid to the limited number of industry suppliers of new labels and bottles ordered on such short notice; (3) the waste of millions of labels and bottles which could not be used; and (4) the burdens in educating foreign suppliers in foreign languages about technical matters and assuring their compliance with the new rule.

If necessary equipment changes could not be made in time and hand application of extra strip labels with ingredient information were required, the cost of implementation and first year of operation would be $198.98 million in 1983 for the distilled spirits industry alone. This estimate was filed by DISCUS in 1983 in response to an order of the Court of Appeals requesting comment on a suggestion from the Center for Science in the Public Interest that the use of strip labels would be inexpensive and simple and could be done quickly. Please see DISCUS memoranda filed with the Court of Appeals, dated June 24, 1983; August 3, 1983; August 19, 1983; and November 27, 1985, which set forth ingredient labeling cost data, attached hereto.

We submit that it is unwise and unnecessary to place this burden on an already financially troubled industry until the litigation is completed and we know what rule, if any, will be imposed on the industry.

3. Health Claim.

The Center for Science in the Public Interest ("CSPI") has claimed that a failure to implement ingredient labeling immediately will cause serious harm to the public health. Such claims are simply untrue.

The record from BATF's four rulemakings contains no medical support for such a claim. The record is replete with medical and scientific evidence that any allergenic components of the basic ingredients of distilled spirits do not carry over in distillation of the alcohol to the final product. The record is virtually devoid of concrete evidence supporting CSPI's alleged health benefits of ingredient labeling.

In its most recent rulemaking BATF decided to rescind a previous rule which would have required shotgun ingredient disclosure, finding that labeling based on standards of identity provided proper protection of the public and that shotgun labeling would provide the public with misleading information, including the implication that grains and yeast which go into alcohol production carry nutritional value in the final product. BATF decided to require disclosure of FD&C Yellow No.

5 on labels because of possible effects on the health of a certain percentage of the population. BATF also announced that it would evaluate the need to disclose other ingredients on a case-by-case basis.

The agency has been pursuing label disclosure rulemakings for other ingredients or additives. It recently required label disclosure of saccharin and has under way a rulemaking by which it proposes to require labeling of sulfites. The language we request appear in the appropriations bill would in no way affect BATF's ability to go forward with the sulfite rulemaking and other rulemakings it might wish to undertake.

4. Recent Legislative History.

Soon after BATF published proposed regulations in 1979 the House Appropriations Committee stated its position in the ingredient labeling matter:

> "On February 2, 1979 the Bureau published in the Federal Register several proposed regulations which would require the ingredient labeling of alcoholic beverages. The Committee believes that these proposed regulations represent another unnecessary burden on United States industry, the cost of which is passed on to the consumer. The Committee has, therefore, inserted language in the accompanying bill which would prohibit the use of any funds appropriated to the Bureau for issuing or carrying out any of the proposed regulations." (H.R. Rep. No. 96-248, 96th Congress, 1st Sess. 10 (1979))

In 1983 the House stated the view that the courts should have the opportunity to make a final decision on this matter before the regulations were implemented. Because a Treasury Appropriations Bill was not enacted that year, this language was eventually incorporated into the Continuing Resolution for Fiscal Year 1984. The prohibition was maintained in the Continuing Resolutions for Fiscal Years 1985 and 1986. (Pub.L. No. 99-103, 99 Stat. 471 (Sept. 30, 1985); H.J. Res. 441, 131 Cong. Rec. S15295 (daily ed. Nov 13, 1985; P.L. 99-190))

In short, Congress has clearly and consistently expressed the view that the courts should have the opportunity to review the regulations under the Federal Alcohol Administration Act prior to the time that they are implemented. We request that this sensible approach be continued.

Conclusion:

For the reasons of (1) sound management of government expenditures and (2) avoidance of an expensive and wasteful burden on businesses and alternatively on consumers, we believe it is important for the Subcommittee to continue to prohibit the use of funds to implement the 1980 ingredient labeling rule (T.D. ATF-66) until there is a conclusion of all judicial and rulemaking proceedings. We respectfully

CONTINUED MONTHLY COLLECTION OF BATF STATISTICS

The Distilled Spirits Council of the United States, Inc., on behalf of the beverage alcohol industry, urges the committee to continue to require that BATF collect and publish statistics on distilled spirits on a monthly rather than quarterly basis, as has been proposed by the Office of Management and Budget (OMB). Any reduction in the frequency of these reports would hinder the ability of DISCUS and its member companies to market, plan and focus on industry problems, including problems of alcohol abuse. Timely statistics are especially needed for the operations of a strongly regulated industry such as ours, which has significant social responsibilities and which collects over $12.6 billion annually in taxes on behalf of local, state, and the federal government.

Monthly statistics are needed and quarterly statistics are insufficient because:

- monthly statistics advance efficient industry operations by providing current information on distillation, bottling and other industry developments -- information essential for making timely company decisions. Quarterly statistics would be months late for usefulness in reaching important decisions;

- planning of future production and marketing depends on monthly statistics rather than stale, historical data;

- inventory, accounting and company records must be related to current, monthly statistics;

- errors would be difficult to detect and correct in quarterly reports.

In summary, quarterly statistics could mask important changes and would be too late for making decisions and plans. Monthly data are vital as a guide to the future for our industry and for others affected by our industry.

DISCUS understands that a need for statistics by government must be shown to justify their collection. Also, we understand that an objective of OMB's Paperwork Reduction Program is to lighten the burden on those who supply raw materials for these statistics. We would like to assure you that our industry gladly assumes this "burden" and asks not to be relieved. It welcomes the "burden" in the interest of advancing the industry's operations and its marketing and social responsibilities.

Additionally, we are informed that government agencies responsible for controlling our industry require these statistics to, among other things, determine satisfaction of excise tax liabilities, prevent illegal production and provide the basis for various inspection programs.

Because we believe that collection of monthly statistics is in the public interest since it makes current data available for an important social industry - an industry that makes substantial contributions to government revenues and the U.S. economy - DISCUS requests that your Subcommittee include language in its report that would mandate the continued monthly collection of statistics by BATF during fiscal year 1987, notwithstanding any OMB directive to the contrary.

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS

Senator ABDNOR. The subcommittee has received a statement from the National Association of Tobacco Distributors [NATD] with regard to the Bureau of Alcohol, Tobacco and Firearms. Without objection, it will be placed at this point in the record.

[The statement follows:]

STATEMENT OF TERRY BURNS, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS

On behalf of the National Association of Tobacco Distributors (NATD) we would like to submit the following comments for the permanent hearing record, regarding Fiscal Year 1987, Bureau of Alcohol, Tobacco and Firearms (BATF) Appropriations in the cigarette contraband enforcement program.

The National Association of Tobacco Distributors (NATD), represents over 570 corporate wholesaler-distributor members with over 740 distribution outlets, and represents 230 manufacturer and supplier associates whose 12,000 salesmen canvass and supply almost 1.5 million retail outlets selling tobacco products across the United States. It is estimated that members of the Association's trade and industry market goods with an annual wholesale value of over $16.0 billion dollars.

Representatives of the association have appeared before your Subcommittee every year for the past four years to present their concerns regarding appropriations for the Treasury Department and, in particular, the impact which the funding level for the Bureau of Alcohol, Tobacco and Firearms (ATF) has on our industry. There is no other national trade association besides ours with a membership more directly affected by the decisions, regulations and enforcement functions of the tobacco part of the ATF.

The Association opposes the recommended budget for ATF tobacco law enforcement functions contained in the Department of the Treasury Fiscal Year 1987 Justification For Appropriations, submitted to this Subcommittee for consideration. The ATF has recommended no funding for this function for Fiscal Year 1987, which would be a reduction of $4.2 million from the Fiscal Year 1986 level, despite the fact that the Administration has proposed budget increases in all other areas of ATF law enforcement functions. As a result of this lack of funding, the ATF FY 1987 work would involve no investigations and no suspects targeted for prosecution regarding cigarette contraband.

The NATD believes that the Administration is wrong in its repeated attempts to eliminate the enforcement function under this ATF activity. We recommend maintaining this program at the Fiscal Year 1986 level of $4.185 million with 56 positions dedicated to the cigarette contraband enforcement function, as the Congress has done for the past five years.

Last year this Subcommittee restored over $3.3 million for the Cigarette Contraband Enforcement Program in Fiscal Year 1986. At that time the Subcommittee indicated that the "Committee views these programs, as revenue collection activities, most important and therefore, directs ATF to use the restored funding to work on these and other priority areas."

The NATD believes these funds are well spent on behalf of the U.S. taxpayers. Cigarettes are a significant revenue source for the federal government budget, with an estimated $4.8 billion in revenue expected during FY 1986. It seems altogether fitting and proper that the federal government does its fair share to ensure that the distribution system for cigarettes in the United States is free from the pressures of smuggling, bootlegging and organized crime. Appropriations for the ATF in the amount of $4.185 million for FY 1987 is the least that could be done given the magnitude of the revenue contributions made by the federal cigarette excise tax.

Yet there are many other policy justifications for continued funding of ATF tobacco enforcement functions beyond the fact that cigarette excise taxes produce such a large revenue.

The basic cause of cigarette smuggling is the disparity in state and local cigarette tax rates, which produce the incentive for smuggling and bootlegging. These excise taxes continue to rise on a state and local level. For example, the price for a pack of cigarettes in Chicago includes 16 cents federal tax, 20 cents state tax, 15 cents city tax and 8 cents county tax, for a total of 59 cents in excise taxes while the price of a pack of cigarettes from the neighboring State of Kentucky includes only 16 cents federal tax and a mere 3 cents state tax for a total of 19 cents in excise taxes. A bootlegger would receive a profit of 40 cents for every pack of cigarettes, or $4.00 for every carton, which was purchased in Kentucky, trucked to Chicago and sold at the same price as similar packs sold through legitimate channels.

Indianapolis Boulevard is the dividing line between the City of Chicago, the State of Indiana. On the west side, the Illinois side that is, the excise tax on a pack of cigarettes is 59 cents. On the Indiana side it is 26 1/2 cents, or a difference of $3.35 per carton. The State of Illinois has put on 12 investigators, effective November 1, 1985, to curtail the cigarette contraband and bootlegging activities on this street alone. The Illinois Association of Candy and Tobacco Distributors informs us that as of March 1, 1986, when the new Illinois tax was effective, the State of Illinois estimated that it is loosing over $30 million per year from bootlegged cigarettes.

The situation in Illinois is not unique, according to our tobacco wholesaler members located around the country. For example, in New York a major tobacco-wholesale company had five hijackings in four weeks and now maintains armed guards in its warehouses to prevent cigarette smuggling. Enclosed with this correspondence is a March 17, 1986 letter from Paul Crotty, Commissioner of Finance for the City of New York to George Elicofon, Executive Director of the New York State Association of Tobacco and Candy Distributors. Mr. Crotty, indicates that the cuts in this area would "compromise the ability or collect the taxes due on cigarettes."

If I were in the organized crime family, I would be pleased to see the end of federal cigarette contraband enforcement functions. In fact, I would encourage a further reduction to virtually eliminate all agents, investigations and programs in this area. However, we at NATD strongly believe that now is not the time to reduce this law-enforcement function.

The circumstances which foster cigarette tax evasion schemes have not been eliminated, but rather have been enhanced; and hense there is a greater motive for the resurgence of this activity. The only solution is a continued federal presence in the tobacco enforcement area. The federal presence is a deterrent to organized crime, and assistance to state enforcement authorities, and the only means to control a problem which is, by definition, an interstate problem.

Therefore, we urge the Subcommittee to appropriate $4.185 million for Fiscal Year 1987 for the cigarette contraband enforcement area in the Bureau of Alcohol, Tobacco and Firearms. Funding at this level, which is the same as that of Fiscal Year 1986, will allow ATF to fulfill its important responsibilities.

LETTER FROM PAUL A. CROTTY, COMMISSIONER OF FINANCE, CITY OF NEW YORK

March 17, 1986

Mr. George Elicofon
Executive Director
New York State Association of
Tobacco and Candy Distributors, Inc.
211 East 43rd Street
New York, New York 10017

Dear Mr. Elicofon:

Thank you for your letter regarding proposed cuts in the proposed federal budget for Fiscal 1987.

The proposed savings are very short sighted because they will compromise the ability to collect the taxes due on alcohol and cigarettes. We share your concern about the loss of funding to the Bureau of Alcohol, Tobacco and Firearms. This is an area, as you know, which requires close monitoring.

Also, thank you for commending Ms. Mildred Zaky. It is a pleasure knowing that we have such knowledgeable, efficient and courteous employees at the Department of Finance.

Thank you for writing to me about you concerns.

Sincerely yours,

Paul A Crotty

Paul A. Crotty

INTERNAL REVENUE SERVICE

STATEMENT OF ROBERT M. TOBIAS, NATIONAL PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

Senator ABDNOR. Our next witness is Mr. Robert Tobias of the National Treasury Employees Union.

Sorry to hold you up, but I think you'll agree that this fits best into our schedule with the next witnesses that we have.

Mr. TOBIAS. Thank you very much, Mr. Chairman.

It pleases me to be here to testify in behalf of the Internal Revenue Service and the U.S. Customs Service budget. I would first like to discuss briefly the Internal Revenue Service.

We've heard much lately that the Internal Revenue Service is an agency on the mend, that it's fixed, that it's out of trouble, but frankly, I don't think it is fixed. We notice in the material that it has submitted to Congress this year that it is projecting that it will be collecting $4.5 billion less in taxes this year than last year.

We notice that the tax compliance gap is increasing from last year at $86 billion to $92 billion this year and it's projected to be $159 billion annually by 1990.

We also note that people who file refunds; expect them to be returned by June 1. Many of them won't receive their refunds by June 1. The IRS has budgeted some $38 million in interest payments because of its inability to promptly file—to promptly return refunds.

We ask Congress to really take cognizance of the problems that the Internal Revenue Service has had over the past few years and direct the IRS and this administration to produce a plan to restore the voluntary compliance system.

Currently it's at 81.6 percent. It was at 90 percent. We believe that 90 percent is a reasonable goal. We believe that $9 out of $10 ought to be collected as opposed to $8 out of $10. We believe that there is a solution, a very viable solution, a reasonable approach to this tac compliance gap and it lay in more revenue agents to conduct more audits. More revenue officers to collect more taxes. More people in taxpayer service to answer the legitimate inquiries of taxpayers and we also suggest a tax penalty amnesty program, a one time program which would allow for the waiver of penalties and would encourage the nonfilers to get on the roles.

The benefits of this kind of a program would be enormous over 5 years. It would result in $55 billion, if we could just keep the tax compliance gap at 81 percent rather than continuing to fall. Some $20.6 billion in additional revenues, if we hire 5,000 additional revenue agents and $40 billion from an amnesty program for a total of $119.6 billion over 5 years. Now, in anybodys lexicon, that's real money, and we urge that the Senate do what the House Appropriations Committee has done this year and add a $340 million supplemental budget to the Internal Revenue Service for fiscal year 1986.

The money has already been spent by the Internal Revenue in processing taxes this year and we urge the Senate to appropriate the money to make the processing system continue to work.

Senator ABDNOR. If you would stop 1 second here, Mr. Tobias. We wouldn't quarrel about the extra manpower. As you know, this committee attempted last year, in last year's budget, for this year, to insert extra manpower only to have it vetoed. You have got to give us some solutions down there on how we find this money now when they send up the supplemental, because we operate under different rules than the House is operating under and it's got to be accounted for in one way or the other.

This could probably make it easier down there. We'll see what happens, but this is very much on this committee's mind. I mean, the degree that we have impact on this. The amnesty thing is in the hands of the Finance Committee but we've had a lot of interesting experiences with people who support the adding of more people, but when we get on the floor, they vote to cut our budget, including that very item. But, we are very much aware and agree that it is something that has to be looked at, but we're going to have to have a little more cooperation, out of OMB for one thing, to get this thing really going.

Mr. TOBIAS. Well we certainly recognize that this administration has not made it easy for any Member of Congress. First by, in my view, attempting to make the Congress look bad by coming in at a low ball number for the Internal Revenue Service and the U.S. Customs Service, leading the administration to call Members of Congress budget busters for doing what they think is right with respect to IRS and Customs. They vote the money and then the President vetoes it and then in the next breath he comes back up and asks for $340 million which is exactly the amount that he vetoed.

There's no question that the President has made it very difficult and yet, on the other hand, the implication of not funding the Internal Revenue Service would be dramatic indeed.

We would see, somewhere around June 1, we would see furloughs—1 and 2 day furloughs for the entire work force in the Internal Revenue Service. We would see an incredible drop in audits conducted, and revenue collected.

I don't think this country can afford not to fund the Internal Revenue Service, both in terms of just revenue collected, but also in terms of the severe consequences of loss of confidence in the Internal Revenue Service.

Senator ABDNOR. Very good.

PREPARED STATEMENT

Mr. TOBIAS. Thank you, Mr. Chairman. I would ask my complete statement regarding the Internal Revenue Service be included in the record.

Senator ABDNOR. Without objection, your entire statement will be printed in the record.

[The statement follows:]

STATEMENT OF ROBERT M. TOBIAS

I am Robert M. Tobias, National President of the National Treasury Employees Union. Our union is the exclusive representative of over 120,000 Federal workers, including virtually all employees of the Internal Revenue Service. I am accompanied today by Patrick Smith, NTEU Director of Legislation, and Paul Suplizio, Legislative Consultant.

The most serious problem facing the nation's tax system today is the need to stem the fall in voluntary compliance. IRS projects voluntary compliance to fall from 81.6 percent this year to 79 percent by 1990 (Chart 1). This amount may not appear large, but it is enormous when you consider that for each 1 percent decline, $7 billion is lost to the Treasury. Viewed in historical perspective, compliance was around 90 percent in the sixties, fell to 84 percent by 1975, and has been declining steadily since then. As a result, the tax gap -- the difference betwen taxes legally owed and those voluntarily paid -- stands at $100 billion today and will rise to $159 billion by 1990.

There has been a hardening of cynicism toward their tax obligation on the part of many of our citizens. In the words of the General Accounting Office, there is a trend toward contempt and abuse of the system that undermines the compliance of others. An opinion survey conducted for IRS by Yankelovich, Skelly and White found that 20 percent of the sample admitted to cheating on their taxes, and a third believe that it is all right to cheat because others do so. The belief that others cheat and get away with it is the basic reason for non-compliance.

The failure to confront this problem is a national failure -- a failure for which the present Administration bears a large burden of responsibility. Not until after it had plunged the tax system to its lowest performance in history, not until after the humiliating events of the last filing season, not until millions of irate citizens raised their voices in indignation, did the Administration come forward with a sensible budget for IRS in the current fiscal year.

We believe there is still time to restore the system's health but, quite frankly, Mr. Chairman, we have been saying this for six years and time is slipping away.

We must place high on the national agenda the goal of halting the decline in voluntary compliance. And we must provide IRS with the resources necessary to achieve this goal.

We believe that the Federal government should immediately announce a comprehensive program to strengthen enforcement of the tax code and bring non-compliant taxpayers onto the tax rolls once more. Essential components of the program we envision are:

o a one-time tax penalty amnesty, whereby taxpayers who owe money may avoid civil and criminal penalties by paying what they owe plus interest within a specified amnesty period;

- providing IRS with additional enforcement resources, particularly in Examination, Collection, and support staff, to increase enforcement actions against non-compliant taxpayers before and after the amnesty period;
- change the tax code to give IRS better enforcement tools and to increase penalties for non-compliance when the amnesty is over.

We believe stronger enforcement can work in tandem with a one-time amnesty to halt the fall in compliance. Both would result in large additional revenues accruing to the Treasury.

NTEU has computed that just keeping the compliance rate from falling will yield $55 billion over 5 years (Table 12). An additional $20 billion would result from enforcement actions. We should also include part of the $100 billion annually that is now going uncollected, but would be paid by taxpayers as a result of the amnesty.

It is unrealistic to expect that the entire $100 billion would come in if amnesty were declared, as that would imply 100 percent compliance. We estimate that $40-$50 billion could be recovered under an amnesty program, as this figure is consistent with 90 percent compliance.

Adding the sums I have mentioned -- $55 billion from improved compliance, $20 billion from stronger enforcement, and $40-$50 billion from amnesty, yields a total of $115-$125 billion in estimated additional revenue from the program I have outlined. This is the gain if we just keep compliance from falling. If we can raise compliance generally by five percentage points, from 81.6 to 86.6 percent, an additional $35 billion a year would result.

We believe the fact that we have a voluntary compliance system in this country makes amnesty feasible. IRS now has detailed records on all citizens' incomes and filing status, and can identify those who are non-compliant. However, we must face the fact that IRS will never have sufficient resources to deal with all the non-compliant population. By offering such taxpayers a chance to pay up without penalty, we believe a large number can be brought back into voluntary compliance with the law.

Strengthening tax enforcement by examining more returns, collecting more past-due accounts, and putting abusive tax shelters out of business should not be viewed as an imposition on our citizens. I know that many people -- perhaps including some in this room -- believe that IRS should not be "unduly intrusive" into their lives. That philosophy has led to six straight years of declining audit coverage and rampant cheating. In the 1960's, audit coverage was more than 5% and yet our freedoms did not suffer. Effective tax enforcement sends the message that those who do not pay their fair share will be caught and required to pay. It is a bulwark of voluntary compliance.

We welcome the Administration's supplemental request for $340 million for FY 1986. After deducting the Gramm-Rudman cut of $157 million, there will be a net addition to IRS resources of $183 million and 7,000 average positions. These resources are urgently required to assure efficient processing of 6 million additional returns and refunds, to strengthen taxpayer services, and to commence hiring 2,500 additional Revenue Agents and Tax Auditors that are sorely needed and long overdue.

Unfortunately, OMB has a fleeting attention span, because its FY 1987 request for IRS is a reversion to the discredited policies that led to the 1985 fiasco. The evidence on this point is clear. In this budget, OMB authorizes four important program initiatives -- a revenue initiative to strengthen Examinations, a Tax Shelter Initiative to clear up the backlog in Appeals, a Document Matching Initiative to improve collections from underreporters, and an ADP Initiative to strengthen returns processing. These initiatives are essential and long overdue. To implement them, and allow for processing additional returns, 4,300 average positions are required.

Yet the budget provides a net increase of only 1,360 average positions. The remaining resources are to be obtained from within IRS, by reducing Returns Processing. Obviously, the folly of ratcheting the Returns Processing staff level down again escapes OMB. We are told that workload backlogs will be cleaned up this year, so the positions will not be required. But there will be 3.5 million additional returns and supplemental documents to be processed in FY 1987. We are strongly of the opinion that staff in Returns Processing is still inadequate and should not be reduced. Staff completing one-time assignments should be directed to other work. GAO, in earlier reports, has criticized the inefficient practice of ratcheting staff levels up and down in the face of increasing workload. To revert to a policy of cannibalizing some programs to pay for others is sheer folly.

There are two other glaring deficiencies in this budget. First, the number of taxpayers assisted through toll-free telephone, walk-in, and correspondence is projected to fall from 50 to 45 million. There is no justification for such a decrease, particularly if tax reform should be enacted this year.

Second, the Collection staff is to be cut 1,500 positions and the number of Revenue Officers working past-due accounts is to be held constant for the fourth year in a row, despite mounting caseloads. In view of the increasing number of delinquent accounts, the total of more than $30 billion owed in such accounts, and the return of $20 for each dollar spent in Collection, we believe there is no justification for ratcheting down the staff level.

To sum up the IRS budget for FY 1987, NTEU recommends restoration of 2,700 positions to maintain an adequate Returns Processing staff, addition of 500 positions to Taxpayer Service to assure that 50 million taxpayers will again be assisted next year, and restoration of 1,500 positions scheduled to be cut from Collection so that 316,000 more taxpayer delinquent accounts can be worked. These additions would cost $131 million, but would bring in $570 million in additional revenue annually (Tables 1 and 2).

I would now like to bring to your attention two matters that have been the subject of discussion between IRS and NTEU. IRS' improved automation capabilities make possible the statistical measurement of performance against program objectives. We have no objection to using statistics to measure the performance of an organizational unit, but we strongly object to applying this system to individuals. The reason is that it is unwise to have employees subject to performance measures that do not reflect differences in individual situations, and that can readily translate into quotas and production pressure. Experience shows that this would have a negative effect on the morale and retention of employees, on the quality of work, and on taxpayers.

The second matter relates to protecting IRS employees from potentially dangerous taxpayers. Assaults and threats directed against IRS employees increased from 531 in 1983 to 789 in 1984 -- a 50 percent increase. There has been a sharp rise in such incidents since 1981, and their severity has also increased. A Revenue Officer in Buffalo was shot and killed while making a field call; another in Cleveland suffered multiple gunshot wounds at the hands of a taxpayer during a meeting at an IRS office; in Washington, D.C. a taxpayer was convicted of attempting to murder a Revenue Agent. The Service is responding to this serious situation, but problems remain. A way must be found to protect IRS employees from potentially dangerous taxpayers who enter IRS field offices to meet with a Service representative. The Department of Justice must also move vigorously to prosecute individuals involved in assault, threat, and harassment of IRS employees. We need Congress's assistance in this matter, and we are asking for your help.

I would like to conclude by noting that the Yankelovich public opinion survey I mentioned earlier found that a substantial majority of Americans -- about 60 percent -- believe IRS to be trustworthy, accurate, and staffed by knowledgeable people. IRS employees can take satisfaction in this result, knowing that their job is a difficult one and there is a great deal riding on how they perform it. Our voluntary tax compliance system is a great institution and we are not unmindful of our responsibility for preserving it.

Compliance and the Tax Gap

When it comes to providing resources for tax compliance, Congress is in the enviable position of being able to kill two birds with one stone. Additional compliance resources will not only raise revenues directly, but will improve the level of voluntary compliance among taxpayers generally, thereby yielding even more revenue to the Treasury.

This is no unproven theory, as the compliance and collection programs enacted in TEFRA conclusively demonstrate. You will recall that three years ago Congress authorized 5,000 additional positions, and made changes in the tax code to improve taxpayer compliance and collection of past-due accounts. The revenue from this initiative is now being realized, and has been recorded in IRS budget submissions. In Examination, 1,000 additional positions costing $70 million yielded additional revenue of $1.8 billion in FY 1983-1984. In Collection, 4,000 additional positions costing $100 million yielded $1.9 billion in FY 1984. The incremental return for an additional dollar in Examination was 25 to 1. The incremental return in Collection was 19 to 1.

These results show the tremendous revenue potential of our tax system when relatively small increments of resources are added to the substantial plant in existence. Where else in the entire government would an investment of $170 million yield revenues of $3.7 billion? If Congress had been unwilling to act in 1983, the bulk of these revenues would have been lost. But Congress took determined action, and the wisdom of its decision is unquestionable.

In its recent report on deficit-reduction options for FY 1987, the Congressional Budget Office has estimated that addition of 1,550 examiners for FY 1987-91 at a cost of $0.2 billion would yield additional revenues of $3.9 billion -- a rate of return of $19.50 for each dollar spent. CBO's annual estimates, published in Reducing the Deficit: Spending and Revenues Options, support the view that raising audit coverage would improve taxpayer compliance and generate substantial additional revenues.

Failure to act to stem the deterioration of tax compliance that has occurred over the past decade would not only lead to large revenues foregone from taxpayers unwilling to pay their fair share, but would lead to further erosion of tax receipts through a "ripple effect" upon honest taxpayers of the perception that all are not paying their fair share. It is the shift of attitudes among taxpayers generally, prompted by recurrent reports of tax shelter abuses, under-reporters, and non-filers who play "audit roulette" and get away with it, that poses the greatest threat to our voluntary compliance system.

Mr. William J. Anderson of the General Accounting Office summed up this problem when he told a House Government Operations subcommittee:

> "There is a trend toward contempt and abuse of the system which seriously undermines the basic concept of voluntary compliance on which the system depends. Extensive evidence is available to show that noncompliance among both corporate and individual taxpayers is a serious problem and is getting worse."

In 1984, the Internal Revenue Service completed five years of exhaustive research into the state of taxpayer compliance and noncompliance. Its findings are a report card on the health of our voluntary compliance system.

The IRS study found that the tax gap -- the difference between taxes legally owed and voluntarily paid -- on corporate and individual income was $81.5 billion in 1981. By far the largest component of the tax gap, $52 billion, is attributed to unreported income on returns of individuals. Overstated business expenses and personal deductions accounted for another $13 billion lost on individual returns, while the corporation tax gap was $6.2 billion.

The study estimated the unreported income of individuals in 1981 to be $250 billion, of which $95 billion was wages and salaries, $58 billion was nonfarm proprietor income and small business corporation income, $20 billion was interest income, $18 billion was capital gains income, and $17 billion was "informal supplier income". Informal suppliers are those engaged in "off-the-books" transactions of the kind associated with the underground economy.

For each component of personal income, the IRS computed "voluntary reporting percentages". This is the percentage of income of both filers and nonfilers that was voluntarily reported. The study found that 94 percent of wages and salaries, 84 percent of dividends, 86 percent of interest, 59 percent of capital gains, 79 percent of nonfarm proprietor and small business corporation income, and 21 percent of informal supplier income was voluntarily reported to IRS in 1981. Overall, 89.3 percent of taxable income was voluntarily reported, compared to 91.2 percent in 1973. There has been a steady decline of about .2 percent a year in voluntary reporting since 1973.

Even more significant is the fact that IRS has had to revise its overall estimate of tax compliance by individuals from a 90 percent voluntary compliance rate before the study was made to 80 percent thereafter. IRS found the state of individual taxpayer compliance to be much lower than the results it had been getting earlier from its Taxpayer Compliance Measurement Program.

The voluntary compliance rate is the percentage of taxes voluntarily paid to taxes legally due. While the voluntary reporting percentage shows the amount of income voluntarily reported, there are additional tax losses due to overstated expenses and deductions, which brings the overall compliance rate down to 80 percent.

According to Fortune magazine for April 14, 1986, IRS expects the tax gap to widen from $100 billion this year to $159 billion by 1990. Taken together with compliance data submitted by the Commissioner in testimony last year, NTEU has been able to record the trend of the tax gap between 1974 and 1990. This is shown in Table 4.

The 73 percent increase in the tax gap forecast by IRS between tax years 1986 and 1990 clearly demonstrates that the decline in compliance is accelerating. As the economy grows, rising personal incomes means there will be more income subject to taxation. Even if the percentage of this income that goes unreported remains the same, the tax gap will rise because of the larger amount of taxable income.

A rise in the tax gap to $159 billion in FY 1991 implies a decline in voluntary compliance from the present 81.6 percent to 79 percent. This is shown in Table 5. Voluntary compliance rate is the percentage of taxes legally owed that are voluntarily paid. From Budget of the U.S. Government we are able to forecast budget receipts in FY 1991. Receipts plus the tax gap equals the amount legally owed. Receipts divided by the amount legally owed equals 79 percent for FY 1991.

Chart 1, which was prepared by GAO, shows the enormous consequences of the tax gap for Federal revenues. It plots the rising tax gap against a forecast of the Federal budget deficit. The chart shows that this year about half the deficit could be financed if the tax gap were collected. By 1988, the deficit could be wiped out because the tax gap will equal the projected deficit.

Recovery of these enormous revenue losses is not only an urgent national need, it is essential to stem the downward trend of noncompliance and insure that everyone in society pays his fair share of the tax burden. Reversing this downward trend is essential to the survival of our voluntary compliance system.

Prompt action is required to achieve these goals. Congress should:

o Establish a 90 percent voluntary compliance level as an objective. IRS should be required to report to the Congress annually its progress toward achieving this objective. The impact on voluntary compliance from the 2,500 additional examination positions approved for FY 1987-1989 should be assessed each year, and further positions should be added until the compliance goal is reached. An intermediate goal of 85 percent should be set for FY 1991.

o Assure that the principal components of our tax administration system that bear upon voluntary compliance -- examination, collection, returns processing, and taxpayer service, receive balanced increases in additional resources commensurate with their workload.

- Provide IRS with sufficient resources to deal with special compliance problems, including abusive tax shelters, income underreporting, delinquent accounts receivable, offshore tax havens, and payer non-compliance.

- Require IRS to provide resource impact statements indicating any additional funds and staff-years required to implement tax law changes made by Congress.

- As the General Accounting Office has recommended, require IRS to submit with its budget request each year a statement of how it would allocate an additional 2,500, 5,000, and 7,500 positions, together with the revenue return and impact on voluntary compliance that can be expected from each increment.

Fundamental Imbalance Between IRS Workload and Resources

A large and growing gap between IRS workload and resources has emerged over the past decade. The deterioration in compliance we are witnessing stems in large measure from the generally inadequate level of resources provided. The number of primary returns filed will increase 43 percent between 1975 and

1987. In contrast, total staff years will increase only 15 percent, even with the significant additions in FY 1986-87.

As more people enter the labor force, the number of taxpayers increases and so do the number of tax returns filed. Without changing the tax law, this basic workload is uncontrollable. A growing number of returns must be processed, refunds scheduled, examinations conducted, and accounts collected. The increasing complexity of our tax laws adds to the basic workload by making the processing of returns more time-consuming.

At the same time, compliance problems posed by tax protesters, tax shelters, and the underground economy have risen in magnitude. New missions, such as implementing the Deficit Reduction Act, and the Interest and Dividends Tax Compliance Act, have proliferated. Billions of dollars in past-due taxes have accumulated. Offshore tax havens have emerged as a major new challenge.

The disparity between workload and resources that has been accumulating for a dozen years has plunged the tax administration system to the lowest levels of performance in history. Audit coverage in FY 1986 will be the lowest ever, 1.1 percent. This marks the sixth straight year in which coverage has remained below 2 percent. Because of fewer examinations, additional tax assessments will fall from $17.7 billion in FY 1985 to

$14.4 billion in FY 1986, a loss of $3.3 billion dollars.

The Appeals backlog will rise from 66,000 to 120,000 cases between FY 1985 and FY 1986 due to the large number of tax shelter cases under examination. This represents an 81 percent increase in a single year. Because of static resources, the average caseload per appeals officer will leap 60 percent.

Delinquent returns secured from non-filers will be 17,000 fewer this year and $523 million less revenue will be collected in the delinquent returns program than in FY 1985. Delinquent returns investigations are increasing faster than dispositions, causing the caseload backlog to rise by 483,000 cases or 78 percent over FY 1984, at a time when top priority should be given to reducing this backlog. The number of average positions working delinquent returns fell from 4,389 in FY 1984 to 3,898 in FY 1985, and will fall again to 3,499 this year. This is a 20 percent decline in two years. The number of delinquent returns investigations closed will fall by 96,000 during this period.

The backlog buildup in delinquent returns clearly illustrates what has come to be accepted management practice in IRS. Due to inadequate budgets, resources are shifted into the most pressing programs while other programs are starved until unacceptable backlogs result. Then and only then is OMB persuaded to authorize an "initiative" for one or two years to clean up the backlog. In the meantime, the statute of limitations continues to run, and many leads are lost due to caseload ageing.

As a result of this policy, IRS programs are chronically out of balance. One-time shots of resources to clean up backlogs only aggravate the problem, for it is likely that some other program will be reduced to provide the resources. Not only is the overall IRS staffing level ratcheted up and down by OMB, but the staffing levels of major functions within IRS are being ratcheted in the same manner by this stop-and-go system.

This problem is starkly illustrated by several examples in recent years:

o The number of taxpayer delinquent accounts in Collection was allowed to rise between 1978 and 1982 until a huge backlog was created. Finally, in FY 1983 4,000 positions were added to that function to clean up the backlog. A total of 1,700 of these positions were taken from IRS programs. While the backlog has been reduced, it is still not at manageable levels. Yet the FY 1987 budget calls for a 2,000 position reduction in Collection staff.

o After staff-years in Returns Processing were reduced by 7,000 positions between 1980 and 1984, a collapse took place in this function in 1985. The situation was only restored by an infusion of 7,200 positions in FY 1985 and FY 1986 (bringing Returns Processing back to the level of 1980 -- see Table 3). In the FY 1987 budget, OMB begins to repeat the earlier pattern. With 30,000 positions required (this is admitted in the budget submission itself) to process a growing volume of returns, only 27,300 are allowed -- a reduction of 2,700 positions.

- Between 1980 and 1986, the number of returns examined fell constantly and millions of returns with audit potential went unexamined (Table 9). After six years of serious deterioration in compliance, IRS will soon commence hiring the first of 7,500 positions to be added (2,500 per year) during FY 1987-89. Additional revenue of $10.3 billion will be generated by this program over 5 years. Much more than this has already been lost since 1980: at least $12 billion in direct enforcement revenue, and another $11 billion from the fall in voluntary compliance from 82.1 to 81.6 percent.
- As a result of very necessary program emphasis on tax shelter cases, the backlog in Appeals has grown to unmanageable proportions during the past four years. For FY 1987, IRS

is requesting a "tax shelter initiative" of 465 positions to reduce this backlog. However, the amount requested is insufficient as the backlog is projected to continue growing.

The consequences of this pattern for the voluntary compliance system are obvious and severe. Mounting unpaid tax bills, unexamined returns, correspondence backlogs and periodic breakdowns in processing returns and refunds -- all take a severe toll on compliance. Considering the extraordinary harm inflicted, it is unfortunate that a system of actively preventing imbalances has not been grasped by OMB.

The interesting thing about these episodes is that all of the conditions were predictable, and were known to management and OMB. To its credit, IRS requested far more resources than OMB granted. Instead of increasing resources in step with workload, maintaining the tax administration system in balance, OMB's policy has been one of first causing imbalances by denying needed resources, and then plugging the gaps when the situation got out of hand. OMB has been both arsonist and fireman in this absurd style of management.

The General Accounting Office has taken issue with OMB on this score. It stated:

> "This ratcheting of staffing levels makes it extremely difficult to develop well-founded plans for acquiring, training, and focusing human resources on the multi-faceted task of

administering the tax system. A larger and more consistent level of resources to keep pace with growing demand on the tax system appears in order."

IRS IS Not Retaining Its Best People

A major problem limiting the effectiveness of IRS enforcement staff is the high rate of attrition among Revenue Agents, Tax Auditors and Revenue Officers. In FY 1984, the attrition rate for Revenue Agents was 7.4 percent, for Tax Auditors 9.3 percent, and for Revenue Officers 8.3 percent (see Table 6). These figures alone fail to present the full dimensions of an extremely serious problem:

- More experienced Revenue Agents are leaving the Service than inexperienced agents. An IRS study of voluntary separations in FY 1979 showed that losses in GS-9 through GS-13 positions were 63 percent of the total number of Revenue Agent quits that year. The other 37 percent who quit were in grades GS-5 through GS-7.

- The field offices with the highest quit rates of experienced personnel are located principally in the Sunbelt states of the Southeast and Southwest. In FY 1984, the average separation rate for all regions was 11.4 percent. Regions with above-average separation rates were the Southeast (12.5%), Southwest (14.0%) and Mid-Atlantic (14.6%). Among service centers, where average attrition was 9.5 percent in FY 1984, Austin

(13.3%) and Andover (17.0%) had the highest turnover rates.

- Inadequate salary is the most important factor in this attrition. An article written by Richard Whitmore of the Gannet News Service, entitled, "Best Accountants Leaving IRS for Greener Pastures", states:

  > "In the past decade, as the salary gap has widened between IRS and private accounting firms, the normal trickle of revenue agents and executives out of the IRS has turned into a flow. Unlike average workers at the Agriculture Department or the Labor Department, for example, many IRS workers have skills that could bring them a lot of money on the outside -- a raise of $10,000-$20,000 for an average revenue agent....."

- The skill and competence of an experienced Revenue Agent makes him a valuable commodity for whom alternative employment opportunities abound. In the article above, Whitmore cites the following case:

  > "In 1981, at the age of 31 and earning $35,000, Richard Flowers reached the peak of his IRS career. So, after twelve years with the Philadelphia District Office, Flowers left, looking for a job in private industry with more potential....Flowers got a good raise and limitless potential working as a tax specialist for a Philadelphia energy company."

- IRS is increasingly unable to compete with the salary scales of the private sector in attracting quality accounting graduates. An IRS study completed in 1981 found that the average starting salary offer in the private sector to Bachelor's degree candidates in accounting was $16,728. At the 50th percentile, the salary offer for graduates with a Bachelor's degree in accounting was $16,800. The starting salary offer at the 10th percentile, above which 90 percent of the offers were made, was $15,000. These figures compared to IRS starting offers of $12,266 at GS-5 and $15,193 at GS-7 level. The study concluded that salary is a critical factor in the initial recruitment of quality trainees. "Substandard salaries, all else being equal, will result in a substantial number of substandard hires."

- Today, an entry-level Revenue Agent, who must have completed some accounting courses in the process of earning a college degree, makes $14,390; he advances to just $26,381 in his fourth year. IRS Commissioner Egger is quoted in the April 14, 1986 issue of *Fortune* as saying: "It takes three years to develop tax examiners, and we're keeping less than 25 percent of people at the three-year level."
- Between FY 1980 and FY 1983, attrition rates declined, reflecting some improvement in this situation. However, this was a period of economic recession, and recovery kindles a resurgence of the outflow. In FY 1984, attrition rates shot up sharply. The forces creating the underlying problem -- the drain of talent, inadequate salaries, inability to compete for quality

graduates, and declining experience level of the overall workforce, have persisted and worsened.

Unless remedial action is taken, these conditions will seriously impair the effectiveness of the IRS enforcement staff. Symptoms of this have already begun to emerge. William Penick, a senior partner in the accounting firm of Arthur Anderson, is quoted in the Whitmore article as saying:

> "The average agent has less experience, less maturity, and just doesn't have the self-confidence to deal with the issues themselves and work out solutions. The most complex of the tax areas are not black and white and where there are grey areas, you should compromise. The older agent knows from practical experience what makes sense, but the young guys don't have the self-confidence to settle the issues themselves."

Former IRS Commissioner Jerome Kurtz adds:

> "You hear a lot of complaints from sophisticated taxpayers that the quality of the people they deal with does not seem the same....what happens is that frequently the more complex issues are not raised, or are settled on a less-than-optimum basis. There are still a lot of very good revenue agents out there, but you don't see them coming along at the same rate as you used to."

Congress and the Administration need to address the problem of IRS salary scales being out of line with the private sector in terms of both pay and responsibility. For too long, the Federal government has kept the upper grade of an Internal Revenue Agent at the GS-13 level, despite the tremendous growth in complexity of our tax laws and the degree of accounting sophistication with which returns are prepared. A

Revenue Agent's responsibility in auditing a complex return of a corporation or partnership today, and the commensurate skills required, are much greater than a decade ago. In order to overcome the starting salary problem, IRS has already begun to hire Revenue Agents at higher entry grade levels. If experienced agents are to be retained, it is essential that the senior grade level for a revenue Agent be raised to GS-14.

The mismatch in relative pay and responsibility between IRS Revenue Agents and their corporate counterparts is well-known and has existed for some time. Whitmore succinctly summarizes it:

> "The bottom line is this: A relatively inexperienced $25,000-a-year revenue agent sitting across the table from a $60,000-a-year private accountant or comptroller backed up by a $100,000-a-year tax lawyer."

Congress can help to correct this situation by requiring the Administration to immediately raise starting salaries and improve the grade structure for Revenue Agents, Revenue Officers, and Tax Auditors. Congress should establish standards for higher grades in appropriate situations if the Administration refuses to do so. In addition, it should provide additional pay to permit IRS to attract and retain high calibre individuals in occupations where the Service is having recruitment and retention difficulties.

At the same time, IRS should be required to formulate and implement, with Congressional support, an Employee Retention Program covering critical occupations where attrition is excessive. The Employee Retention Program should contain measures designed to enhance the attractiveness of the employee's job, upgrade professionalism, provide greater career opportunities, and increase recognition of outstanding performance.

Examination and Appeals

Examination and Appeals is the backbone of IRS' efforts to achieve a high degree of voluntary compliance with the tax laws. The willingness of taxpayers to file tax returns, correctly assess their liability, and make timely payment is influenced by their perception that these actions will be required if not done voluntarily. Voluntary compliance is dependent to a significant degree on public confidence that IRS is able to identify noncompliance and will take corrective action.

The General Accounting Office has made this point succinctly:

> "It is important to keep in mind that IRS' various compliance activities do no more than require citizens to pay those taxes that were properly due in the first place, and that in fact were so paid by most of their number. Effective compliance should not be viewed as representing a special burden to the public at large; rather it is aimed at insuring that all share their fair burden."

Publicity given to the underground economy, abusive tax shelters, and other forms of noncompliance can have an adverse effect upon compliance among the general public. A perception is fostered that all are not paying their fair share of taxes. This can create a "ripple effect" among normally honest taxpayers, causing them to cheat because what they have read, seen or heard has convinced them that "everyone is doing it.

A public opinion survey conducted by Yankelovich, Skelly and White bears this out, for a majority believe that the public is cheating on their taxes, and that tax cheating is becoming more prevalent. One in five admitted to cheating on their own returns, while one in three took positions that strongly condoned cheating. The perception that others are cheating and getting away with it can seriously undermine our system of voluntary compliance.

Given the overwhelming evidence of sharply declining compliance and its ruinous impact on the tax system, to complacently accept the 1.1 percent audit coverage for FY 1986 would be a blueprint for disaster. It would assure continuation of the declining trend in voluntary compliance at the critical moment when we should be moving decisively to prevent any further ripple effect among honest taxpayers.

Fortunately, OMB has finally seen fit to deal with the problem. We are gratified that, after much prodding by NTEU and Congress, OMB has come forward with a revenue initiative that will add 2,500 Examination positions each year for FY 1987-1989. The cost of these positions in 1987 is $94.4 million, in 1988 $188.8 million, and in 1989 $283.2 million -- a total investment of $566.4 million over three years. The anticipated revenue return over the five-year period FY 1987-1991 is $10.3 billion, or an incremental return of $18 for each dollar spent.

We strongly support the revenue initiative as the minimum essential requirement in Examination after six years of neglect, and we would go further and urge that a minimum of 5,000 positions should be added each year betwen FY 1988 and FY 1990 if we are serious about stemming the decline in voluntary compliance.

We do no believe that 2,500 positions a year, representing a mere 6 percent average increase each year, will be adequate to deal with both the immediate problem of restoring prudent audit coverage, and the more fundamental problem of reducing the amount of underreporting, tax sheltering, overstating deductions, and similar schemes that have taken root in the taxpaying population. Our 5,000 position alternative (to begin in FY 1988) would increase Examination strength an average of 10.6 percent a year -- an amount more realistically proportioned to the dimensions of the compliance problem.

Examination must deal with special compliance issues of major dimensions, including underreporting, abusive tax shelters, and offshore tax havens.

In the area of underreporting, IRS has chosen to focus on the relatively low compliance levels of sole proprietorships and small business corporations. The most recent study of the tax gap concluded that $58.4 billion in income from these two sources was not reported in 1981. Altogether, 21.3 percent of sole proprietor and small business corporation income went unreported.

This problem was also raised by earlier evidence from the Taxpayer Compliance Measurement Program, which found that compliance among small business taxpayers with adjusted gross incomes under $10,000 fell from 79.2 percent in 1965 to 43.2 percent in 1976. This means that these taxpayers paid only 43 percent of the taxes they owed in 1976, and the situation has worsened considerably since then.

The GAO subsequently analyzed TCMP data for small corporations, those with assets of up to $1 million, between 1969 and 1978. Compliance for this group dropped almost ten percentage points from 83.1 to 73.3 percent during those years, and has undoubtedly declined further since.

In order to attack this problem successfully, IRS will need to refine its tools for identifying tax returns with significant amounts of unreported income. More thorough audits will have to be conducted. IRS states that it is now emphasizing quality audits over quantity. It notes that, as the tax laws have grown more complex, audits are dealing with more complex issues and are taking more time to complete. They are also yielding more revenue.

Examination is also at the forefront of IRS' efforts to deal with abusive tax shelters. These shelters generate, through inflated asset valuations and other devices, deductions and credits far in excess of funds placed at risk. Tax shelter schemes, both legitimate and abusive, are widely publicized and highly visible. As their use increases, public confidence in our tax system falls.

IRS is making some inroads against abusive tax shelters, but not nearly enough progress as necessary. At the end of FY 1982, it had 285,000 tax shelter cases under examination and recovered $1 billion out of an estimated $6 billion in questionable deductions. At the end of Fiscal Year 1983, the number of cases increased to 334,549 and IRS recovered $1.8 billion out of approximately $7 billion in questionable deductions. In FY 1984, the number stood at 331,395 and $2.2 billion was recovered on 114,323 cases closed -- an average of $19,240 per return.

In FY 1985, the number of tax shelter cases rose to 372,000, with an estimated $8 billion in questionable deductions. The tax shelter initiative will permit closure of 26,000 additional cases and accelerate collection by $600 million in FY 1987 -- about $23,000 per return.

IRS estimates that it loses $3.6 billion annually due to illegal tax shelters. Over the four-year period FY '81 to FY '84, the Annual Reports of the Commissioner showed that IRS recovered $5.6 billion of the $14.4 billion potential loss. In other words, the net loss to the Treasury from tax shelters alone for this period was nearly $9 billion.

It is little wonder that the sale of tax shelters is growing by leaps and bounds. The use of shelters is now spreading from upper-bracket to middle-bracket taxpayers. In a recent study, the Joint Committee on Taxation states:

> "A major concern is that the highly visible marketing of tax shelters, and the accompanying belief that the Internal Revenue Service cannot deal with them, may erode taxpayers' confidence in the fairness and effectiveness of the tax system.....The widespread use of tax shelters deprives the system of its claim to fairness and retards the administrative and judicial processes to the point that penalties seem neither certain nor costly....The growth of shelters feeds on itself: As the tax base is eroded, rates must be raised to maintain revenues which in turn increases the demand for tax shelters."

Because most tax shelters are structured as limited partnerships, where income or loss is flowed through and taxed at the partner level, IRS significantly increased its examinations of partnership returns in 1983 by 16,000, and raised the audit coverage of those returns from 1.63 to 2.41 percent in a single year. (Audit coverage for individual, partnership, and corporation returns in shown in Table 10.) This additional emphasis has raised assessments, but considering the large backlog of unresolved cases and the fact that audit coverage was again reduced in 1984, it is evident that current resources are totally inadeuate to deal with this major problem.

The increased emphasis on partnership returns was accompanied by a sharp drop in the number of corporate returns audited -- 22,000 fewer in 1983 than in 1982. Under the Reagan Administration, audit coverage of corporation returns which stood at 8 percent in 1978, plunged to 2.66 percent last year. We have previously called the attention of Congress to the decline, which can only be stemmed by providing IRS with the necessary resources and directing that a minimum audit coverage for corporations be maintained. Failure to stem the sharp decline in corporate audits will only fuel the perception that the tax policies of this Administration are weighted toward "corporate America" at the expense of the individual taxpayer.

Offshore tax havens are a newly-emerging compliance problem that also requires significantly strengthened examination resources. The practice of sheltering income from U.S. taxes by transferring funds to off-shore tax haven jurisdictions is becoming increasingly widespread. The Commissioner of Internal Revenue told Congress:

> "It is clear that billions of dollars in taxes are being lost through these mechanisms and equally clear that narcotics traffickers and other elements of organized crime, illegal tax protesters and promoters of abusive tax shelters, to name just a few, are intimately involved in these transactions."

An article in the Washington Post for March 26, 1984 described a Federal grand jury indictment of the Omni International Corporation and four of its executives for tax fraud associated with shifting corporate income to a subsidiary located in an off-shore tax haven. The government charged that Omni put $16.8 million worth of income on its Bermuda subsidiary's books, but only reported $91,574 of that income on its tax returns.

Money flows related to tax haven transactions are frequently hidden by the secrecy requirements established by foreign jurisdictions. The IRS study of the tax gap completed in 1984 states:

> "Indirect evidence suggests that tax haven funds may have been increasing at extraordinary rates. For example, it has been estimated that between 1968 and 1978, international deposits made by non-bank depositors in banks located in all important tax haven areas increased from $5.3 billion to $88.7 billion, an average rate of growth of 33 percent per year. Since it is more convenient for U.S. taxpayers to use the facilities of banks in the Caribbean Basin (which are in or near the same time zones as the major U.S. money center banks), it is of some interest that between 1970 and 1978, deposits (excluding deposits held by other banks) in Western Hemisphere tax haven banks increased from $2.0 billion to $31.5 billion, an average growth rate of 41 percent per year."

The Chief Counsel of the President's Commission on Organized Crime has stated that, "all too often some banks condone money laundering because the balance sheets draw no distinction between legal and illegal monies." Several large banks have received stiff fines for failure to report, as required by law, millions of dollars in cash transactions with foreign banks.

To cope with this problem, IRS has approximately 325 international examiners to handle audits of business operations outside the United States. The majority of these audits involve multinational corporations. However, the spreading use of tax havens requires expanded attention to the operations of individuals, partnerships and trusts. International issues will increasingly become an integral part of many audits. IRS' existing resources are far too small to deal with this problem adequately, and additional resources should be provided.

The Applellate Division of IRS is under severe strain from mounting caseloads, largely associated with abusive tax shelters, and backlogged inventories at historic highs. The imbalance between workload and resources which we have described is nowhere better illustrated than in Appeals. The backlog of unresolved cases will climb from 66,500 at the end of FY 1985 to 109,600 at the end of FY 1986 -- a 65 percent increase. Even with the tax shelter initiative that will add 465 additional positions (including 140 Appeals Officers) in FY 1987, the backlog will grow to 120,000 at the end of that year. Clearly, more resources are required than the Administration has provided in its initiative.

This starkly worsening situation is graphically depicted in the following table:

	Caseload Inventory	Unresolved Deficiencies and Penalties
End FY 1981	27,000	
End FY 1982	50,000	$12.2 billion
End FY 1983	62,600	$16.5 billion
End FY 1984	70,900	
End FY 1985	66,500	$20.0 billion
End FY 1986	109,600	
End FY 1987	120,200	

An increase of 300 Appeals Officers as part of the 1983 revenue initiative was expected to reduce the average caseload to 48 cases. However, workload has continued to grow. The average caseload per Appeals Officer has risen sharply from 63 cases at the end of FY 1983 to 101 cases at the end of FY 1986.

At the same time that the Appeals backlog has been growing, so has the backlog of cases docketed before the Tax Court. The inventory of docketed cases stood at 52,700 at the end of FY 1982, will rise to 82,400 at the end of FY 1985, and climb to 99,800 at the end of FY 1986. This condition is bound to have severe repercussions upon the Appellate system. The pressure to keep Tax Court caseloads manageable is resulting in expedited settlements in Appeals, something that NTEU predicted two years ago when the Appellate Division was placed under the Chief Counsel's office.

Appeals' agreement rate on cases docketed before the Tax Court increased from 57.1 percent in 1981 to

84.1 percent in 1983 and 83 percent in 1984. Of nondocketed cases, Appeals settled 85 percent in 1983 and 84 percent in 1984. On tax shelter cases alone, Appeals closed 64 percent more cases in 1984 than in 1983. The agreement rate on tax shelter cases rose from 72 percent to 77 percent. Of the tax shelter cases closed in 1984, 7,870 were docketed cases in which agreement was reached before trial, an increase of 88 percent over 1983.

The 1983 Annual Report of the Chief Counsel states that the increased number of agreements avoided unnecessary litigation for both taxpayers and the government and resulted in earlier tax collections. It also states that increased settlments of docketed cases reduced the rate of increase in the Tax Court's tax shelter inventory.

The question remains whether the goal of achieving a fair settlement with the taxpayer is being supplanted by the interest of the Chief Counsel in keeping litigation caseloads manageable. Appeals Officers must be given adequate authority over dispute resolution. They are highly-skilled professionals who, by virtue of their years of experience, are among the most technically knowledgeable in the IRS. Their job is to strive for settlements in the best interests of the taxpayer and the government. We fear that, as we have predicted, the extreme pressure that the administrative and judicial system is under will lead to erosion of the quality of settlements in Appeals.

It is incredible that in these circumstances OMB has not allowed sufficient additional resources for Appeals. We believe that a minimum of 400 additional Appeals Officers are required above the 465 provided, and that IRS should be given the flexibility to assign additional positions to Appeals out of the 2,500 positions recommended for Examination and Appeals in the revenue initiative contained in the President's budget.

Collection

Collection is responsible for collecting delinquent tax accounts and obtaining delinquent tax returns after the taxpayer has failed to respond to written notice. Mounting unpaid tax accounts and nonfiling of required returns have been persistent signals of increasing taxpayer noncompliance in recent years.

It is imperative that Collection activities be fair and executed professionally, because such actions can involve the seizure of a taxpayer's business or other assets. Since a seizure effectively shuts a business down, the interest of the government in protecting the revenue and the interest of the taxpayers, many of whom are small businessmen, must be carefully weighed.

As the representative of IRS employees, we wish to reiterate our conviction that seizures do not make sense in many cases. The taxpayer loses his business and the Federal government loses revenue. Seizures should only be used as a last resort -- not as a means of improving statistics on some manager's chart.

The pressure to close cases is often a contributing factor in unwarranted seizures. Production pressure placed upon Revenue Officers by management, using statistical measures of performance that emphasize closing the maximum number of cases in a minimum amount of time, is a major problem in Collection. Supervisors remain wedded to an archaic system of management, emphasizing quantity over quality in order to make the unit's performance look good on paper. The result is a large number of cases handled poorly rather than a smaller number handled well.

Revenue Officers handle the most complex and serious cases of tax delinquency, including fraudulent transfers, transferee assessments, 100 percent penalty assessments, use of nominees and alter egos, and others. Yet last year a Revenue Officer computed that, in five years on the job, he had spent an average of less than nine hours per case closed.

NTEU has cautioned in the past that hasty closures can result in agreements that are neither fair to the taxpayer nor fair to the government. We once again call upon Congress to direct IRS to overhaul its management methods in Collection. Quality standards should be established for case settlements, and IRS should set realistic norms for the time required to meet such standards. In complex cases, Revenue Officers should be allowed adequate time to do a quality job.

Revenue Officers can assist IRS in determining quality standards and setting work unit norms that reflect quality as well as quantity. Quality work plans, developed by field units with the participation of employees, should form the basis of the national plan, rather than quantitative goals established by the national office being arbitrarily imposed upon the work force.

NTEU has been informed that IRS plans to test a new aspect of the Automated Collection System, which will attempt to increase the volume of delinquent account contacts through use of "computerized conversations" with the taxpayers. In other words, after the call goes through and a live operator confirms the identity of the respondent, and obtains his concurrence to proceed with the computerized message, the computer would take over and obtain the taxpayer's response to taped questions. We believe that taxpayers will not respond favorably to interfacing with computers, and we will be watching this test carefully to advise Congress on whether it makes sense to commit funds to such a program. We have strong reservations about depersonalizing contact with the taxpayer, as it fosters the image of IRS as distant, unfeeling, and impossible to get through to.

Despite its automated collection system, IRS is having to run faster to stay in the same place in collecting past-due accounts. Between FY 1976 and FY 1985, collections rose five-fold, from $3.5 to $18.3 billion. But revenue in the active inventory of delinquent accounts also rose five times, from $1.7 to $9.1 billion, and the number of delinquent accounts doubled.

GAO stated last year: "IRS' collections resources have not kept pace with growing delinquent account and delinquent return inventories." GAO pointed out that the actual amount of total accounts receivable outstanding was $30.1 billion. Of this amount, $18.2 billion was in the collection process, $6.3 billion was classified as currently not collectible, and $5.6 billion was in other accounts (Chart 2 and Table 11).

There are far more accounts to be worked than resources available. Between March, 1983 and March, 1985 the number of delinquent accounts being worked by Revenue Officers increased 15 percent while the number of Revenue Officers increased by only 1 percent. In view of this situation, we urge that 1,500 positions the Administration proposes to cut from Collection be restored at a cost of $47 million. This will permit working 316,000 more taxpayer delinquent accounts each year, yielding additional revenue of $570 million annually (Tables 1 and 2).

Alternatively, 400 staff-years could be applied to restore delinquent returns investigations to the 3,898 level of FY 1985. The remaining 1100 positions would be used to collect taxpayer delinquent accounts. We earlier noted that the backlog of delinquent returns investigations is rising sharply due to staff reductions. By adding 400 positions to maintain the FY 1985 level, 394,000 more delinquent returns could be secured involving $609 million in additional assessments as a result of securing these returns. The 1100 positions applied to taxpayer delinquent accounts would yield additional collections of $417 million. This amount plus the delinquent return assessments come to a total of $1.025 billion from expenditure of $47 million for 1,500 additional positions in FY 1987 -- a return of $22 for each dollar spent.

Assaults and Threats Against IRS Employees

Congress the problem of increased danger to IRS employees from threats and assaults stemming from the performance of their duty. The number of assaults and threats rose from 485 in 1982 to 789 in 1984, a 63 percent increase in two years.

We would like to stress our firm conviction that the vast majority of taxpayers are patient and understanding in their relations with IRS. The problem of assaults and threats is confined to a relatively small number of individuals. Nevertheless, because enforcement action can be perceived by some persons as unjust or a threat to their well-being or lifestyle, IRS employees must be constantly alert to the risk of possible assault, retaliation, or harrassment to themselves and their families.

The problem is particularly acute in the Collection area where Revenue Officers are involved in direct enforcement action, such as seizure of a business or attachment of assets. It has been standard Collection procedure for many years for Revenue Officers to work in pairs in making seizures and to arrange for Criminal Investigation or local police escorts when necessry. Since 1970, Collection has designated High Assault Risk Areas and allowed Revenue Officers to work in pairs in these areas.

Revenue Officers receive training on how to recognize and react to threatening situations that may arise in the performance of their enforcement duties, and what to do if an assault or threat occurs. The training helps to make employees aware of behavior or actions on their part which can contribute to the development of potentially dangerous situations.

The recent publication by IRS, at NTEU's urging, of a new manual supplement -- IRM 810 -- will help IRS employees to identify potentially dangerous taxpayers. IRS employees have the right to refuse to work with such taxpayers or to demand armed assistance in dealing with them.

Collection has also established an Assault and Threat Reporting System, which requires employees to report all assaults, threats and harassment incidents for investigation by Inspection Branch and follow-up action to provide necessary protection. Analysis of this data for 1981-1984 has revealed that both the number of total incidents and the number of assaults has increased dramatically in the last three years. Analysis also indicates that there are a growing number of taxpayers who are openly hostile to Service employees.

These findings document how more dangerous and stressful the Revenue Officer occupation has become in recent years. Shootings of Revenue Officers in Buffalo and Cleveland show how serious the situation is. The hazards and stresses of the occupation are not unlike those experienced by law enforcement personnel, and NTEU believes Congress should consider establishing special retirement for Revenue Officers similar to that provided for law enforcement personnel.

We also strongly urge Congress to impress upon the Department of Justice the necessity for vigorous prosection of individuals involved in assault, threat, and harassment incidents against IRS employees. Prosecution is an important deterrent that is indispensable to the protection of Revenue Officers, and these employees have the right to expect such support from their government.

Returns Processing

The ten IRS Service Centers will be required to process 178 million primary returns in FY 1987, an increase of 8.6 million over FY 1985 (Table 5). Individual tax refunds will be scheduled for 1.8 million more taxpayers than in 1985. The Information Returns Program will have to process approximately 38 million additional information returns and issue 1.25 million more underreporter notices than currently.

In light of this workload growth, the Administration's budget request for Returns Processing is completely unrealistic and should be rejected. The budget document states that 1,143 additional positions will be required in FY 1987, consisting of 660 positions to strengthen the Information Returns Program, 473 positions to process additonal returns, and 10 positions for the ADP program. Added to the FY 1986 level of 28,944 positions, this means that a total of 30,087 positions are required in FY 1987.

By contrast, the Administration's budget allows 27,327 positions, a shortfall of 2,760 positions over the number it admits are required. the Administration claims that these positions are "non-recurring", that they were utilized to clean up backlogs during FY 1985 and FY 1986, and will no longer be required once this work has been completed. NTEU's view is that employees completing assigned projects should be directed to other work, which is obviously at hand from the increased work requirements spelled out in the budget.

Moreover, to ratchet the Returns Processing staff level down again in the face of rising workload is to miss completely the lesson of 1985. From FY 1980 to FY 1984, OMB reduced Returns Processing staff by 7,000 positions, draining all reserves out of the system and reducing the flexibility needed to cope with unforseen developments. As the Commissioner himself has testified, this contributed significantly to the disastrous 1985 filing season.

NTEU's alternative budget restores the 2,700 positions cut in Returns Processing at a cost of $68.3 million (Table 1). We strongly urge the Subcommittee to approve this additional amount and not allow the Returns Processing staff to fall in FY 1987.

NTEU would like to bring to the attention of the Subcommittee the new IRS policy of contracting out to private entities the processing of confidential estimated tax forms (1040-ES). This practice is now underway in Atlanta, where the Citizens and Southern Bank was awarded a contract to process the returns of Florida residents and in Chicago, where the First National Bank of Chicago is processing the returns of Chicago residents. The taxpayers involved have no knowledge of what is happening, as the forms are addressed to IRS at a post office box leased by the banks. In view of the importance Congress and the American people attach to the confidentiality of tax returns, and the obvious danger of compromising the security of returns and computer tapes holding taxpayer information once they are out of IRS control, NTEU strongly urges Congress to bar the use of appropriated funds to administer these activities.

Taxpayer Service

We strongly believe that our tradition of voluntary compliance depends on the taxpayer's willingness and ability to self-assess his tax and file a return, and Taxpayer Service contributes importantly to this end.

Moreover, the increasing complexity of the tax code has led to a steady growth in the number of taxpayers requesting IRS assistance. This is shown in Table 8. Whereas in 1976 the number of taxpayers requesting IRS assistace was 52 percent of the number filing individual returns, by 1984 the proportion had risen to 63 percent.

We estimate that by FY 1987, 66 million taxpayers will request IRS assistance, mainly through the toll-free telephone system, but also through correspondence and walk-in service. Of this number, 45.7 million or 69 percent will be assisted if the Administration's budget is approved. This will be the lowest percentage assisted in a decade, as Table 8 shows.

The number of taxpayers assisted under the Administration's proposal will be 4.5 million less than the 50 million assisted in 1984 and 1985.

Additional resources are clearly required to curb this decline, but the Administration's budget fails to provide them.

NTEU's alternative budget would provide 500 additional positions for Taxpayer Service, at a cost of $15.6 million (Table 2). This would permit assisting 50.3 million taxpayers, 4.6 million more than in the Administration's program. Under NTEU's program, the percentage of taxpayers assisted would be 76 percent - approximately the level of 1984 and 1985. This means that IRS would help three out of every four taxpayers requesting assistance. As the Taxpayer Service system is under severe strain, we believe this is the lowest service level that we can safely tolerate.

We strongly urge the Congress to approve the additional 500 positions for Taxpayer Service. We must recognize that the demand for taxpayer service is rising as the complexity of the tax code increases and tax law changes are made more frequently. We believe that helping three out of four taxpayers requesting assistance is the minimum service level that IRS should strive for. This cannot be achieved without additional resources, and we urge Congress to provide these funds.

Conclusion

In conclusion, Mr. Chairman, we strongly urge Congress to approve a budget which substantially increases the resources available to IRS in

FY 1987. The minimum increase that should be considered, if we are to maintain FY 1985 program levels and accomodate normal workload growth, is NTEU's recommendation for 4,700 additional staff-years and $130.9 million. This program would raise $570 million in FY 1987, and $2.8 billion over the period FY 1987-1989, over the revenue that would accrue under the Administration's budget request (Table 2).

Congress has a rare opportunity not only to reverse the trend of deteriorating voluntary compliance, but to raise significant revenues during a time of crisis in the Federal budget. The enormous size of the tax compliance gap means that additional revenues can be rapidly obtained. The success of past revenue initiatives bears this out. Both the Congressional Budget Office and the General Accounting Office, chief advisors to the Congress in these matters, have emphasized the revenue yield to be gained when relatively small increments of resources are added to the tremendous plant already in existence.

In closing, allow me to pay tribute to the thousands of men and women who collect the revenue of the Federal government. They maintain, with skill and devotion, the integrity of one of our most vital institutions. Recently, you may have read about the results of the Yankelovich Public Opinion Survey which IRS commissioned. It found tht a substantial majority of the American people -- about 60 percent -- believe IRS to be trustworthy, accurate, and staffed by knowledgeable people. The dedicated employees of IRS have worked hard to earn this trust, and I can assure you they will continue to strive for even higher levels of service to the American taxpayer.

Mr. Chairman, I appreciate the opportunity to appear before you today. I am prepared to answer any questions you may have.

TABLE 1

INTERNAL REVENUE SERVICE FY 87 BUDGET REQUEST AND NTEU RECOMMENDATION

	FY 86 CONTINUING RESOLUTION AND SUPPLEMENTAL[1]		FY 87 BUDGET REQUEST		INCREASE OR DECREASE		NTEU RECOMMENDED ADDITION TO RESTORE TO FY86 LEVEL AND PROVIDE FOR WORKLOAD GROWTH[2]		NTEU RECOMMENDED APPROPRIATION FOR FY 1987	
	($000) Amount	Average Positions	($000) Amount	Average Positions	($000) Amount	Average Positions	($000) Amount	Average Positions	($000) Amount	Average Positions
Salaries and Expenses	89,958	2,071	95,147	2,044	+5,189	-27			95,147	2,044
Processing Tax Returns	1,213,769	28,944	1,262,902	27,327	+49,133	-1,617	+68,325	+2,700	1,331,227	30,027
Examination and Appeals	1,427,121	35,923	1,603,162	38,974	+176,041	+3,051			1,603,162	38,974
Investigation Collection & Taxpayer Service	1,095,289	26,786	1,136,581	26,739	+41,292	-47	+62,550	+2,000	1,199,131	28,739
TOTAL	3,826,137	93,724	4,097,792	95,084	+271,655	+1,360	+130,875	+4,700	4,228,667	99,784

[1] Includes Supplemental Appropriation of $340 million and 6,950 positions, and Gramm-Rudman cut of $156.6 million.

[2] Includes restoration of 2,700 positions eliminated on assumption that current filing and processing backlog problems have been corrected, additional 500 positions for taxpayer service to maintain FY 85 level of assistance (50.2 million taxpayers assisted), and 1500 positions for collection to maintain FY 1985 staff levels and collect $570 million annually in additional revenue from delinquent accounts.

TABLE 2

NTEU FY 87 RECOMMENDATION AND NET REVENUE GENERATED, FY 1987-FY 1991

	Recommended Additions for FY 87		Additional Revenue Collected		Cost FY 87 -FY 91	Net Increase in Revenue FY 87-91
	(Staff-Years)	Cost (Millions)	FY 87 (Millions)	FY 87-91 (Millions)	(Millions)	(Millions)
Processing Tax Returns[1]	+2,700	68.3	-0-	-0-	342	-342
Collection[2]	+1,500	46.9	570	2,850	235	+2,615
Taxpayer Service[3]	+500	15.6	-0-	-0-	78	-78
TOTAL	+4,700	130.8	570	2,850	655	+2,195

[1] NTEU would avoid at all cost ratcheting staffing levels down again and run the risk of being unable to process the 3.5 million additional returns and supplemental documents anticipated in FY 1987. Unreasonable staff reductions were a principal cause of recent failures. Staff completing one-time assignments should be redirected to other work and by no means reduced.

[2] NTEU addition would permit closing 316,000 more taxpayer delinquent accounts per year than the Administration's program. This would result in collecting addtitional revenue of $570 million annually.

[3] NTEU program would permit assisting 50 million taxpayers, 5 million more than the Administration's program.

TABLE 3.—INTERNAL REVENUE SERVICE STAFFING COMPARED TO WORKLOAD 1975–87 ILLUSTRATING RATCHETING OF STAFFING LEVELS THAT GAO HAS CRITICIZED AS INEFFICIENT

	Total staff positions	Returns processing positions	Primary returns filed	Information returns
1975	82,339		125,096,000	
1976	84,264		123,100,000	
1977	83,743		127,800,000	
1978	85,329		129,100,000	
1979	86,188		134,700,000	
1980	87,464	28,744	137,382,000	547,000,000
1981	86,156	27,481	138,763,000	645,000,000
1982	82,857	23,919	162,814,000	664,000,000
1983	83.605	20.533	171,174.000	678,000,000
1984	87.635	21,743	164,626.000	692,000,000
1985	92,254	26,075	170,021,000	783,000,000
1986	93,724	28,944	175,868.000	893,000,000
1387	95,084	27.327	178,622,000	931,000,000

TABLE 4.—*Income tax gap, 1974–90*

Tax year	*Income tax gap* [1]
1974	$29,000,000,000
1975	39,000,000,000
1980	62,000,000,000
1982	81,000,000,000
1986	92,000,000,000
1990	159,000,000,000

[1] Difference between taxes legally owed and voluntarily paid.

Source: IRS; 1990 figure quoted from IRS sources in Fortune, April 14, 1986, p. 84.

TABLE 5.—*Voluntary compliance rate, fiscal year 1974–91*

[In percent]

Fiscal year	*Voluntary compliance* [1]
1974	84.0
1980	82.1
1986	81.6
1991	79.0

[1] Percent of taxes legally owed that are voluntarily paid.

Source: IRS data for fiscal year 1974, 1980, and 1986; 1991 estimate based on IRS tax gap projection and income tax receipts in Budget of U.S. Government for Fiscal Year 1987.

TABLE 6.—SEPARATION RATES FOR KEY IRS OCCUPATIONS

Fiscal year	Revenue agents	Revenue officers	Tax auditors
1967	10.4	11.1	12.4
1968	10.4	11.0	11.0
1969	8.9	7.2	7.5
1970	8.6	7.9	9.1
1971	6.8	8.2	12.0
1972	6.6	7.8	10.3
1973	7.8	8.3	10.6
1974	6.4	7.4	11.7
1975	6.4	6.6	9.6
1976	4.7	6.0	7.0
1977	7.5	7.3	9.5
1978	8.6	8.4	10.9
1979	10.5	9.3	10.0
1980	11.6	9.9	11.2
1981	8.1	8.0	8.5
1982	7.5	8.0	8.6
1983	5.5	7.1	6.7
1984	7.4	8.3	9.3

Source: Internal Revenue Service.

TABLE 7.—INTERNAL REVENUE SERVICE EMPLOYMENT HISTORY SELECTED OCCUPATIONS

[Average positions]

	Revenue agents	Tax auditors	Revenue officers	Special agents	Appeals officers
Fiscal year:					
1981 actual	13,272	4,079	5,323	2,751	835
1982 actual	13,554	3,888	6,028	2,685	821
1983 actual	13,613	3,821	7,301	2,593	891
1984 actual	13,405	3,459	7,527	2,790	1,031
1985 actual	13,554	3,513	7,387	2,821	1,050
1986 authorized	14,671	3,761	7,389	2,791	1,101
1987 estimate	15,866	3,796	7,393	2,791	1,240
Change:					
Number:					
1987 over 1986	1,195	35	4	0	139
1987 over 1981	2,594	-283	2,070	40	405
Percent:					
1987 over 1986	8.15	0.93	0.05	0.00	12.62
1987 over 1981	19.54	-6.94	38.89	1.45	48.50

TABLE 8.—NUMBER OF TAXPAYERS REQUESTING IRS ASSISTANCE VERSUS NUMBER ACTUALLY ASSISTED

	Number of taxpayers filing individual returns (1)	Number of taxpayers requesting IRS assistance[1] (2)	Percent requesting assistance[2] (3)	Number of taxpayers assisted[3] (4)	Percent assisted[4] (5)
1976	85,600,000	45,000,000	52	41,900,000	93
1977	86,400,000	47,000,000	54	40,200,000	86
1978	87,400,000	44,700,000	51	38,000,000	85
1979	90,800,000	48,600,000	53	41,000,000	84
1980	93,200,000			43,000,000	
1981	94,000,000			44,800,000	
1982	95,500,000			47,400,000	
1983	95,300,000			47,100,000	
1984	96,300,000	60,800,000	63	50,100,000	82
1985	99,400,000	62,600,000	63	50,200,000	80
1986	103,800,000	65,400,000	63	45,700,000	70
1987:					
Administration proposal	105,500,000	66,500,000	63	45,700,000	69
NTEU alternative	105,500,000	66,500,000	63	50,300,000	76

[1] This column reflects demand for taxpayer service. It includes IRS' estimate of the actual demand on the toll-free telephone system, not just the number of calls answered. For example, in fiscal year 1984 demand was 52 million while calls answered were 41.3 million. Taxpayers seeking walk-in and correspondence assistance are also included. After 1984, the figure is projected by taking 63 percent of the number of filers.

[2] Column 2 as percent of column 1.

[3] Source: IRS budget submissions. Data cover toll-free telephone, walk-in, and correspondence. Figures do not include tele-tax or outreach programs.

[4] Column 4 as percent of column 2.

TABLE 9.—EXAMINATION OF TAX RETURNS FISCAL YEAR 1976–87

	Examination staff-years	Number of examined tax returns	Percentage of tax returns examined
1976	28,100	2,285,000	2.6
1980	28,412	2,179,000	2.1
1981	27,402	1,930,000	1.84
1982	28,117	1,731,000	1.63
1983	27,638	1,676,000	1.56
1984	28,050	1,418,000	1.31
1985	29,009	1,380,000	1.34
1986 (estimate)	29,922	1,271,000	1.14
1987 (estimate)	32,484	1,596,000	1.42

TABLE 10

RETURNS EXAMINED AND AUDIT COVERAGE
FY 1978- FY 1984

	INDIVIDUAL		PARTNERSHIP		CORPORATION	
Fiscal Year	Number Examined	Audit Coverage (%)	Number Examined	Audit Coverage (%)	Number Examined	Audit Coverage (%)
1978	1,845,242	2.16	27,828	2.44	147,340	8.01
1979	1,844,986	2.11	30,474	2.55	142,937	7.44
1980	1,833,858	2.02	23,041	1.79	133,593	6.48
1981	1,644,104	1.77	22,113	1.62	107,363	5.05
1982	1,455,256	1.55	23,084	1.63	107,705	4.73
1983	1,427,660	1.50	36,115	2.41	85,980	3.64
1984	1,215,927	1.27	25,086	1.57	65,803	2.66

TABLE 11.—DELINQUENT ACCOUNTS AND COLLECTIONS FISCAL YEAR 1976–85

	Number of taxpayers delinquent accounts[1] (Millions)	Revenue in TDA active inventory (Billions)	Delinquent accounts (Billions)	Total collection (Billions)
1976	0.6	$1.7		3.5
1980	1.2			
1981	1.4			
1982	2.0			
1983	2.0			
1984	1.9	8.5	$30.1	
1985	1.7	9.1		18.3

[1] Delinquent accounts in active inventory being worked by revenue officers. Does not include accounts in notice process and installment agreements which are about 1.5 times the number of accounts in active inventory.

Source: IRS budgets; GAO for total delinquent account revenue.

TABLE 12.—COMPUTATION OF REVENUE LOSS FROM FALL IN VOLUNTARY COMPLIANCE FISCAL YEAR 1987–91

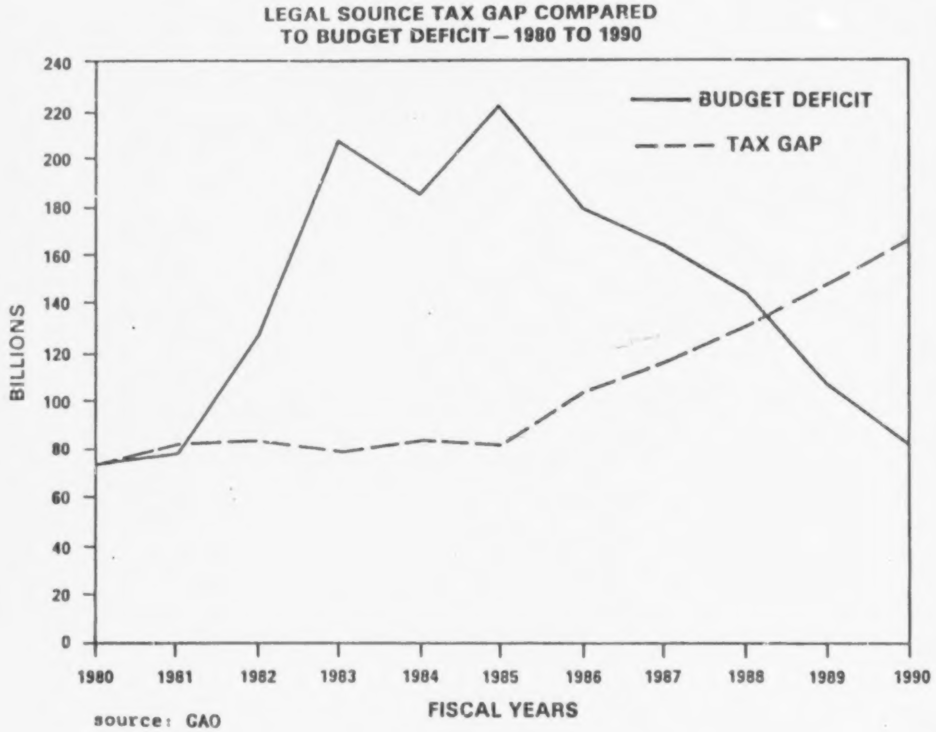
	Compliance rate[1] (Percent)	Difference from fiscal year 1986	Revenue loss at $7 billion per percent[2] (Billions)
1986	81.6		
1987	81.1	0.5	$3.5
1988	80.6	1.0	7.0
1989	80.0	1.6	11.2
1990	79.5	2.1	14.7
1991	79.0	2.6	18.2
Total (over 5 years)			54.6
Direct enforcement revenue from 5,000 additional positions in exams, fiscal year 1988–91 (over 5 years)[3]			20.6
Total revenue gain from action to keep the compliance rate from falling (over 5 years)			75.2

[1] Budget of U.S. Government Fiscal Year 1987, p. 4-3 projects income tax receipts to fiscal year 1989, and have been extrapolated to fiscal year 1990. Tax receipts plus tax gap equals taxes owed. Tax receipts divided by taxes owed equals compliance rate. Tax gap of $159 billion in 1990 corresponds to compliance rate of 79 percent. Since returns are filed in the next fiscal year, the rate is assumed to apply to fiscal year 1991.

[2] Fiscal year 1989 income tax receipts of $567.3 billion plus $145 billion tax gap equals taxes owed of $712 billion, or $7 billion per percent. Fiscal year 1987–91 average is also $7 billion per percent.

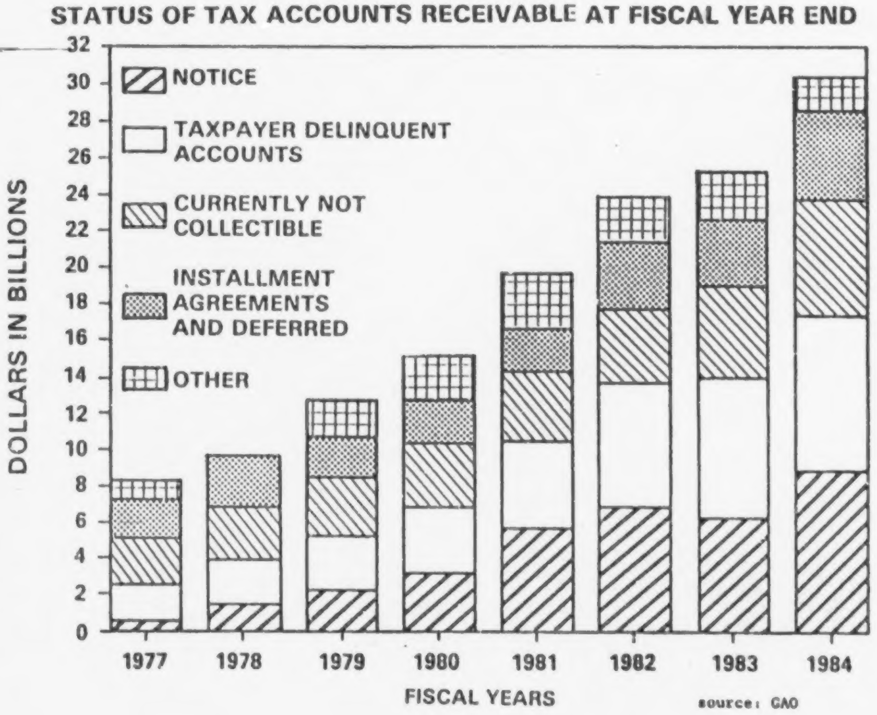
[3] IRS budget estimates yield of $10.3 billion over 5 years for 2,500 additional positions.

CHART 1



source: GAO

CHART 2



source: GAO

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

DEPARTMENT OF THE TREASURY, *et al.*, Appellants, DISTILLED SPIRITS COUNCIL OF THE UNITED STATES, INC., Appellant-Intervenor v. CENTER FOR SCIENCE IN THE PUBLIC INTEREST, *et al.*, Appellees.	Case No. 83-1420 and Consolidated Case Nos. 83-1421 and 83-1419

MOTION FOR STAY PENDING APPEAL

Preliminary Statement

The Distilled Spirits Council of the United States, Inc. ("DISCUS") respectfully moves this Court to stay the order of the District Court, dated February 8, 1983 (attached hereto), pending decision on appeal of that order to this Court. That order directs that regulations that had been rescinded by the Department of the Treasury be restored, thus requiring that the distilled spirits, wine and beer industries revamp their production and bottling systems at great cost to put a list of the ingredients of their products on all labels. This motion is made pursuant to Federal Rule of Appellate Procedure 8(a).

Appellant-intervenor DISCUS previously moved the District Court for a stay pending appeal by Motion and accompanying Memorandum of Points and Authorities filed June 10, 1983. Co-appellant-intervenor Wine Institute similarly filed a motion for stay on June 10, 1983. The Motions of both appellants-intervenors were denied in a one-sentence order issued by Judge Pratt on June 20, 1983 (attached hereto). The order denying the motions for stay was issued in a seemingly peremptory manner, prior to the Court having received an answer in opposition from plaintiffs-appellees, without having heard from the government which is another party adversely affected by the judgment below, and without setting forth the reasons for the decision.[1]

Appellant-intervenor DISCUS now moves this Court for a stay of the District Court's February 8, 1983 Order.[2] The grounds for this motion, which are set forth more fully below, are as follows:

1. The District Court has directed the Bureau of Alcohol, Tobacco and Firearms ("BATF") to implement the ingredient labeling regulations, T.D. ATF-66, 45 Fed. Reg. 40538 (1980), by February 8, 1984. DISCUS' members must begin immediately to implement the procedures necessary for compliance with the mandatory date set in the District Court's order due to the fact that preparation for compliance will take a minimum of 6 to 12 months and probably as long as 15 months. Initial start-up expenses for compliance will cost the distilled spirits industry in excess of $23.88 million dollars; as a result members of the industry will suffer irreparable injury even if DISCUS prevails on appeal.

2. BATF published a notice of proposed rulemaking on June 17, 1983, 48 Fed. Reg. 27782 (1983)[3] to reconsider the ingredient labeling regulations. This new rulemaking may result in the ingredient labeling requirements either being rescinded or materially changed. Any material changes might mean that the time, effort and money spent by the industry in

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[1] DISCUS only was allowed to intervene in this case as of April 7, 1983.

[2] The papers filed herein are substantially identical to the ones filed with the District Court on June 10, 1983 with the exception that a discussion of the new rulemaking announced by the Bureau of Alcohol, Tobacco and Firearms on June 16, 1983, see infra, has been added.

[3] It should be noted that this Court presently has before it federal appellants' Motion for Stay of Appellate Proceedings, filed June 16, 1983, which is predicated in large part on the need to stay the proceedings herein pending the outcome of the new rulemaking. DISCUS is not opposed to the motion given the fact that it faces the need to participate in, and abide by the results of, the new rulemaking.

the meantime to implement T.D. ATF-66 would have been wasted.

3. Plaintiffs and other interested parties will suffer no irreparable harm if the order is stayed pending appeal.

4. Public interest considerations favor the grant of a stay.

5. This case presents serious legal questions and there is a substantial likelihood that the defendants will prevail on appeal in which case the regulations will not become mandatory on the date set by the District Court.

I. The Legal Standard

This Court may grant a stay pending appeal under Federal Rule of Appellate Procedure 8(a), so long as the request is made in the first instance to the District Court as it was here.[4] The case law in this Circuit establishes that the relevant criteria are (1) whether the petitioner will suffer irreparable injury without the stay; (2) whether the stay will substantially harm other parties interested in the proceeding; (3) wherein lies the public interest; and (4) whether petitioner has a substantial likelihood of prevailing on the merits of the appeal. McSurely v. McClellan, 697 F.2d 309, 317 (D.C. Cir. 1982); Washington Metropolitan Area Transit

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[4] Fed. R. App. P. 8(a) provides, in pertinent part:

> Application for a stay of the judgment or order of a district court pending appeal, or for approval of a supersedeas bond, or for an order suspending, modifying, restoring or granting an injunction during the pendency of an appeal must ordinarily be made in the first instance in the district court. A motion for such relief may be made to the court of appeals or to a judge thereof, but the motion shall show . . . that the district court has denied an application . . . with the reasons given by the district court for its action.

As noted the District Court denied the application for stay on June 20, 1983. DISCUS cannot provide "the reasons given by the district court for its action," because it gave none.

Comm'n v. Holiday Tours, Inc., 559 F.2d 841 (D.C. Cir. 1977); Virginia Petroleum Jobbers Ass'n v. Federal Power Comm'n, 259 F.2d 921, 925 (D.C. Cir. 1958).

Where the first three factors strongly favor a stay, as they do here, this Court has required only that the petitioner "demonstrate a 'substantial case on the merits,' even if ultimate success is not a mathematical probability." McSurely v. McClellan, 697 F.2d at 317, quoting Washington Metropolitan Area Transit Comm'n v. Holiday Tours, 559 F.2d at 843. We respectfully submit that under the standards set by this Court, a stay is necessary and appropriate in this case.

II. DISCUS' Members Will Suffer Irreparable Harm If A Stay Is Not Granted.

DISCUS' members will suffer irreparable harm and have no adequate remedy at law if this Court does not grant the requested stay. First, even if the defendants ultimately were to prevail on the merits of their appeal, the start-up time required for implementation -- estimated to be between 6 and 12 months at a minimum[5] -- means that the distilled spirits industry would have been forced to implement extensive and costly changes in its procedures and operations which may prove not to be necessary. Thus, one of the grounds relied on by the government for rescission of the rules, i.e., the high costs of initially implementing the rule, will be lost forever.

Second, BATF has issued a new notice of proposed rulemaking on ingredient labeling and invited public comments. 48 Fed. Reg. 27782 (1983). This new rulemaking may result in

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[5] Orderly implementation of the ingredient labeling rule normally would require approximately 15 months. Declaration of Russell W. Shannon, Secretary and General Counsel of DISCUS, ¶ 3. This would allow for the exhaustion of existing supplies of bottles and labels as well as for the design and production of new bottles and labels, the acquisition of new equipment for the bottling lines, and the acquisition of the requisite governmental approvals. Id. BATF recognized the significant time problems associated with compliance by originally proposing a three-year implementation period. BATF Notice No. 314 at 44 Fed. Reg. 6742, 6747 (1979).

T.D. ATF-66 either being rescinded or materially changed. Any such changes would mean that the time, effort and money spent by the industry in the meantime to implement T.D. ATF-66 would have been wasted. Thus, for each of the reasons specified, DISCUS' members would suffer irreparable harm for which there is no adequate remedy at law.

A. Without a Stay Costly Preparations Must Begin Immediately.

The Declarations of Russell W. Shannon, Carter Hunt, William Wunder, Frank McMorrow, Steven Naclerio, Nello Trevisan, John Heilmann, Hugh Kelly, Robert Guttag, and Thomas McCarthy are submitted with this memorandum.[6] Mr. Shannon, the Secretary and General Counsel of DISCUS, and the other declarants, representing an entire cross-section of the industry, demonstrate in their Declarations the nature and extent of the harm that the distilled spirits industry will suffer in the absence of a stay.[7] Eight of the individual bottlers and importers who have executed Declarations, although representing only a portion of the distilled spirits industry, by themselves project total minimum initial startup costs of over $13,711,000 for compliance with T.D. ATF-66.[8]

Immediate preparation for the February 8, 1984 mandatory date will involve virtually every department of every spirits bottler and importer.[9] Compliance will necessitate the design, production, and inventorying of large numbers of labels for thousands of bottle sizes and brands. The single expense of redesigning the labels for approximately 16,000 brands and/or sizes affected, alone would have cost the distilled spirits industry an estimated $11.34 million in 1980-1981.[10] For the distilled spirits industry, total estimated initial startup costs for 1980-1981, would have been $23.88 million.[11] In view of inflation, the costs would be even greater today.[12]

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[6] These Declarations will be referred to as "[Name of Declarant] Dec." These declarations are copies of the originals, which were appended to DISCUS' Motion for Stay Pending Appeal, filed in the District Court on June 10, 1983.

[7] The companies represented by these declarants are: Austin Nichols & Co., Inc.; Bacardi Imports, Inc.; Black Prince Distillery, Inc.; The Distillers Company, Limited (Delaware); Heublein, Inc.; Hiram Walker & Sons, Inc.; Joseph E. Seagram & Sons, Inc.; Julius Wile Sons & Co., Inc.; and Somerset Importers, Ltd.

[8] The Declaration by the representative of Black Prince Distillery, Inc. did not specify startup cost figures. Mr. Shannon's estimate for the entire industry is $23.88 million based on 1980-1981 costs. Shannon Dec. ¶ 4. Even using the more conservative $13,711,000 figure and recognizing that the declarants only represent eight members of the industry, the costs are very substantial indeed.

In many cases compliance will require the design and production of entirely new bottles. For example, many of the bottles now in use will not accommodate the enlarged labels that will be needed in order to contain the information required by the regulations.[13] In particular, new bottles will be necessary where existing bottles lack sufficient flat surface area to accommodate the new labels.[14] For these brands, entirely new bottles will have to be designed and new bottle molds fabricated to replace the existing bottles.[15] Such changes will entail expenditures of approximately $2.51 million for modification or purchase of new equipment and $1.57 million for new bottle molds.[16]

This process must begin at once because the small number of bottle manufacturers capable of servicing the distilled spirits industry are not able to fill orders without a minimum of six to twelve months lead time even under normal conditions.[17] This normal lead time will be significantly lengthened when orders are placed by the entire industry at once. Similar delays will be experienced when the entire industry orders new labels simultaneously, particularly in light of the fact that there are only a limited number of makers of labels for bottles for distilled spirits.[18]

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[9] Shannon Dec. ¶ 3, Hunt Dec. ¶ 3, McCarthy Dec. ¶ 3, Wunder Dec. ¶ 3.

[10] Shannon Dec. ¶ 4.

[11] Shannon Dec. ¶ 4.

[12] It should be emphasized that none of the figures herein or in the accompanying Declarations include estimates for the separate wine and beer industries.

[13] McCarthy Dec. ¶ 6, Hunt Dec. ¶ 7.

[14] Wunder Dec. ¶ 6.

[15] Trevisan Dec. ¶ 7.

[16] Shannon Dec. ¶ 4.

Distilled spirits labels, unlike labels for most other products, are strictly controlled by statute and regulation, even down to such components as type size, 27 C.F.R. § 5.33(b)(4), and colors, 27 C.F.R. § 5.33(a). Significant administrative changes will need to be implemented by every distiller in anticipation of the mandatory date. The most important of these is the new production, ingredient testing, and record keeping procedures that will be required.[19] This process must begin at once because procedures for obtaining approval of new labels from BATF -- a process that will take much more time than usual because of the thousands of new labels -- will require immediate attention.[20]

In particular, serious fundamental questions may arise as to what constitutes satisfactory labeling specificity, e.g., what is an additive?, how will enzymes be labeled?, can sugar refer to all sweeteners or must the specific type be listed?, must each natural/artificial flavor be listed separately?[21] Such questions will only further compound delays inasmuch as deliberations between industry members and BATF concerning the resolution of technical ambiguities in the rules will take at least several months, even assuming BATF is adequately staffed to handle the sudden surge of policy inquiries.[22] Moreover, because the companies will not be able to order their full complement of initial run new labels until after BATF has approved them, the design and preparation process must begin at once to even have a chance of meeting the February 8, 1984 mandatory date.[23]

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[17] Wunder Dec. ¶ 6, Shannon Dec. ¶ 6. Producers of distilled spirits typically keep an inventory of empty bottles approximately three to six months ahead of when they are to be filled. McCarthy Dec. ¶ 6, Hunt Dec. ¶ 7.

In this respect, it also should be noted that in many cases the existing inventory of bottles and labels will not be entirely used before the February 1984 deadline, thus costing the industry additional money. Naclerio Dec. ¶ 6, Heilmann Dec. ¶ 8, Trevisan Dec. ¶ 8.

[18] McMorrow Dec. ¶ 4, Naclerio Dec. ¶ 5, Heilmann Dec. ¶ 6, Travesian Dec. ¶ 6, Kelly Dec. ¶ 5, Wunder Dec. ¶ 5, McCarthy Dec. ¶ 5, Hunt Dec. ¶ 5.

[19] McCarthy Dec. ¶ 9.

[20] Kelly Dec. ¶ 4, McMorrow Dec. ¶ 4, Trevisan Dec. ¶ 5, McCarthy Dec. ¶ 4, Hunt Dec. ¶ 4, Wunder Dec ¶ 4, Heilmann Dec. ¶ 4.

Many states also require the filing of labels for state label approval and the payment of a substantial fee for each label filed. State requirements accordingly would result in a second major time delay and economic cost.[24] Due to inflation, current total industry expenses for obtaining the requisite federal and state label approvals should run well in excess of the costs estimated for 1980-1981.[25]

For those producers who choose to exercise the so-called address label option, immediate preparation is also necessary and substantial costs will be incurred.[26] The required type size for the address statement is twice as large as that required for ingredient information, and the statement must appear on the front of the bottle.[27] Accordingly, major bottle alterations or entirely new labels will be necessary just as they will for those who list the ingredients.[28] Moreover, the alternative of applying a supplemental label to the front would require the costly and difficult acquisition of pressure-sensitive labeling equipment.[29]

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[21] Wunder Dec. ¶ 4, Naclerio Dec. ¶ 4.

[22] Wunder Dec. ¶ 4.

[23] Kelly Dec. ¶ 4, Wunder Dec. ¶ 4.

[24] Heilmann Dec. ¶ 5, Trevisan Dec. ¶ 5, McCarthy Dec. ¶ 4.

[25] Shannon Dec. ¶ 4. See also Heilmann Dec. ¶ 10, Kelly Dec. ¶ 8, McCarthy Dec. ¶ 8, Naclerio Dec. ¶ 7, Trevisan Dec. ¶ 9.

[26] As an alternate to listing the ingredients on the bottle, T.D. ATF-66 provided that a bottler or importer could elect to furnish the ingredient information directly to the consumer upon request. A statement containing specified language would have to appear on the front of the bottle in large, conspicuous type. 45 Fed. Reg. 40540, 40541 (1980); 27 C.F.R. §§ 5.33(b)(4), 5.39a(a)(2).

[27] 27 C.F.R. §§ 5.33(b)(4) & (5), 5.39(a)(2)(ii); see Naclerio Dec. ¶ 3, Kelly Dec. ¶ 3.

Additional time delay problems will be experienced for distilled spirits produced outside of the United States.[30] Longer lead times are required for foreign produced goods than are experienced by domestic suppliers, due to such factors as additional time needed to prepare goods for export and for shipping.[31] Language barriers, technical difficulties, and the absence of spare trained personnel to send overseas in order to explain the rules to foreign producers will seriously threaten the possibility of full compliance by the mandatory date[32] One major problem is that European laws and understandings concerning the definition of natural, as opposed to artificial, flavorings differ substantially from counterpart American laws and understandings.[33]

B. The New Rulemaking

As noted, on June 17, 1983, BATF published a new notice of proposed rulemaking, 48 Fed. Reg. 27782 (1983), in which it announced its intention to review the ingredient labeling rules ordered into effect by the District Court, to accept new comments and to decide whether to implement ingredient labeling in its present form in view of those comments. This new rulemaking may well result in the ingredient labeling requirements either being rescinded or materially changed. Any material changes might mean that the time, effort and money spent by the industry in the meantime to implement T.D. ATF-66 would have been wasted. Accordingly, the distilled spirits industry has been placed in a position of extreme uncertainty, caught between the order of the District Court and the proceedings in the Department of the Treasury.

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[28] Naclerio Dec. ¶ 3, McCarthy Dec. ¶ 3, Hunt Dec. ¶ 3, Wunder Dec. ¶ 3.

[29] McMorrow Dec. ¶ 4.

[30] Wunder Dec. ¶ 9, McCarthy Dec. ¶ 10.

[31] Trevisan Dec. ¶ 11, Wunder Dec. ¶ 9.

[32] McMorrow Dec. ¶ 4, Naclerio Dec. ¶ 8.

[33] Wunder Dec. ¶ 4, Shannon Dec. ¶ 5.

On the one hand, the industry faces a February 8, 1984 mandatory date for the labeling requirements set forth in T.D. ATF-66. The extensive and costly preparations for timely compliance with those regulations must begin immediately. See Part II(A), supra. On the other hand, the industry faces the strong possibility that the requirements of T.D. ATF-66 either will be abrogated or significantly altered by the new rulemaking. By the time the modified regulations became mandatory, the regulations that DISCUS and its members now must begin to prepare for may well have been rendered moot by the subsequent administrative action.

A stay of the February 8, 1984 mandatory date for compliance with T.D. ATF-66 is therefore essential in order to protect DISCUS members from the compulsion to comply with regulations that may well be superseded in the immediate future. It would be fundamentally unfair to place the distilled spirits industry in a position of having to choose between beginning the extensive and costly process of compliance with regulations that may be rendered moot or, in the event that T.D. ATF-66 is not rescinded or modified, foregoing that preparation with the attendant risk of violating T.D. ATF-66 and the order of the District Court. A stay of the mandatory date will eliminate this dilemma without imposing any concomitant harm or risk on the other parties or the public.

C. The Harm To DISCUS' Members Is Thus Irreparable, And There Is No Means Other Than By Order Of This Court To Avert That Harm.

In the absence of a stay, DISCUS' members will incur substantial costs and be forced to implement extensive changes in their operations in anticipation of complying with regulations that may be significantly altered, rescinded, or held invalid. In either case, there will be no adequate way for the distilled spirits industry to recover its costs. Economic injury is a sufficient basis for granting a stay when there is no possibility of adequate compensatory or other corrective relief at a later date, and the injury therefore is genuinely irreparable. Washington Metropolitan Area Transit Comm'n v. Holiday Tours, Inc., 559 F.2d at 843 n.2; Virginia Petroleum Jobbers Ass'n v. Federal Power Comm'n, 259 F.2d at 925. Here, there is no such possibility of compensation for the costs associated with compliance.

Furthermore, it would be fundamentally unfair to place the distilled spirits industry in a position of having to choose between beginning the extensive and costly process of compliance with the District Court's order when it may be reversed or modified, or foregoing that preparation with the attendant risk of violating T.D. ATF-66 and the order of the District Court. A stay of the mandatory date will eliminate this dilemma without imposing any concomitant harm or risk on the other parties or the public. Accordingly, the grant of a stay is essential.[34]

Obviously the industry is prepared to incur all the time, administrative effort and expense required to make the necessary changes under whatever regulations ultimately result. What DISCUS objects to is having to expend the effort and money to implement regulations which may be rescinded or significantly modified either by this Court or by the agency and to do so in advance of a determination by this Court of the validity of a novel, analytically questionable and, in our view, clearly incorrect decision of the District Court.

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[34] Absent a stay, defendants would run the further economic and legal risk of changing all alcohol beverage labels to comply with T.D. ATF-66, only to have that rule held invalid or modified. The invalidation or significant modification of T.D. ATF-66 could result in thousands of labels being in violation of existing federal and state labeling laws and regulations. For example, listing the substances from which distilled spirits are made could be held misleading since a number of such substances will have been absorbed or changed in the distillation process and thus will not be present in the final product, e.g., a label that a product contains wheat, water and yeast may be challenged by some other "public interest" group as implying nutritional value. McMorrow Dec. ¶ 3.

III. A Stay Of The District Court's Order Will Not Prejudice The Plaintiffs Or Any Other Interested Party And Conforms With The Public Interest.

The purpose and effect of a stay pending appeal is to preserve the status quo during the period in which the regulations are under judicial review. See, e.g., Scripps-Howard Radio, Inc. v. Federal Communications Commission, 316 U.S. 4, 9-11 (1942); Washington Metropolitan Area Transit Comm'n v. Holiday Tours, Inc., 559 F.2d at 844. Currently the ingredient labeling rules at issue are not mandatory. Therefore a stay of the District Court's order will not alter the current labeling regime; rather it will simply preserve the present scheme during the pendency of the appeal. A stay will not require the expenditure of time or funds by BATF or any other party to monitor or comply with the stay.[35] Thus, the only potential adverse effect to the plaintiffs or other parties who advocate such regulations is one of a delay in their effective date.

Time is not of the essence in this case. Ingredient labeling regulations for alcoholic beverages have never been mandatory. Regulations have been considered three times in the last ten years and been rejected two of those times. The District Court's order permitted BATF to set a mandatory date a full year after the date of the order. The delay occasioned by a stay pending appeal will surely be of very little consequence. This is particularly so in light of the fact that the statute, which for the first time has been found to be authority for mandatory ingredient labeling, has been in effect for almost 50 years.

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[35] The status quo is altered by the passage of time, because the distilled spirits industry, wishing to comply with whatever the law is, will have to change its position by the expenditure of tremendous production energies and millions of dollars unless a stay is granted in a timely manner.

Moreover, plaintiffs have not changed their position or otherwise relied upon the District Court's order. By contrast, defendants, as described above, will have to materially and extensively alter their operations and immediately spend considerable sums of money to conform with an order that may ultimately be reversed. This case presents a situation in which there is the potential for serious hardship on the movant if a stay is denied, but no such potential for the other parties if a stay is granted. The "balance of the equities" therefore favors granting a stay pending appeal. Washington Metropolitan Area Transit Comm'n v. Holiday Tours, Inc., 559 F.2d at 845.

Public interest considerations also weigh in favor of granting a stay. Just as the potential for a short delay in the mandatory date will not prejudice the plaintiffs, it will not harm the public.* As noted, no labeling regulations are currently in effect and there has been no public reliance on or expectation of such labeling.

IV. There Is A Substantial Likelihood That The Defendants Will Prevail On Appeal.

Having demonstrated the nature of the irreparable injury and the lack of prejudice to the other parties, it is not necessary for the petitioner to show that it is more likely than not that it will prevail. Rather, when the other factors favor such relief, a court need only find that the movant has a substantial case on the merits. As this Court noted in

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* For that matter, inevitably most if not all of the costs of implementing the ingredient labeling rules will be passed through to consumers in the form of higher shelf prices. McMorrow Dec. ¶ 3. The application of traditional trade margins to higher manufacturing costs will further serve to raise shelf prices. Id. See also 45 Fed. Reg. 48540 (1980). Without a stay, consumers will be forced to bear such extra costs even if the rules contained in T.D. ATF-66 ultimately are abrogated or significantly modified.

Washington Metropolitan Area Transit Comm'n v. Holiday Tours, Inc., 559 F.2d at 843:

> The court is not required to find that ultimate success by the movant is a mathematical probability, and indeed, . . . may grant a stay even though its own approach may be contrary to movant's view of the merits. The necessary "level" or "degree" of possibility of success will vary according to the court's assessment of the other factors.

See also, Providence Journal Co. v. FBI, 595 F.2d 889, 890 (1st Cir. 1979); Goldstein v. Miller, 488 F. Supp. 156, 175 (D. Md. 1980), cert. denied, 454 U.S. 828 (1981); Jordan v. Wolke, 463 F. Supp. 641, 642 (E.D. Wisc. 1978).

A number of factors suggest that this Court will rule the District Court to have been in error:

First, the relief granted by the District Court -- an order that the rescinded regulations become mandatory on a specified date -- was a highly unusual remedy. When a court finds, as the District Court did, that an agency action is not supported by the agency's explanation for its action, the usual remedy is a remand of the case to the agency, not a direction that the agency reverse its action. See, e.g., Federal Power Commission v. Transcontinental Gas Pipeline Corp., 423 U.S. 326 (1976); Camp v. Pitts, 411 U.S. 138 (1973); Environmental Defense Fund v. Costle, 657 F.2d 275 (D.C. Cir. 1981).

Second, the District Court's decision appears to be based in significant part upon the view that State Farm Mutual Automobile Insurance Corp. v. Department of Transportation, 680 F.2d 206 (D.C. Cir.), cert. granted, 103 S.Ct. 340 (1982), requires heightened scrutiny when the action under consideration is a decision to rescind previously promulgated rules. It has never been a settled proposition that the rescission of regulations should be treated differently by agencies and courts than the enactment of regulations, cf. Professional Drivers Council v. Bureau of Motor Carrier Safety, No. 81-2283, slip op. at 9 (D.C. Cir. April 26, 1983) (circumscribed scope of review dictated both by nature of proceeding (informal rulemaking) and by ultimate decision (not to promulgate rules)); Action on Smoking and Health v. Civil Aeronautics Board, No. 79-1044, slip op. at 13, ___ F.2d ___ (D.C. Cir. Jan. 28, 1983) (agency rescission of existing regulations "is reviewable in the same manner" as agency action promulgating new regulations). The Supreme Court, earlier today, June 24, 1983, has issued a decision in State Farm. In reversing the Court of Appeals' decision, which was premised in part on the heightened review of an agency rescission of a rule, the Supreme Court held:

> The Court of Appeals correctly found that the arbitrary and capricious test applied to rescissions of prior agency regulations, but then erred in intensifying the scope of its review based upon its reading of legislative events.

Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Automobile Insurance Co., Nos. 82-354, 82-355, 82-398, slip op. at 13 (U.S. June 24, 1983). Clearly, DISCUS wants this Court to consider Judge Pratt's order in light of State Farm, after the parties have had sufficient time to review, analyze and brief the effect of the Supreme Court's opinion on this case.

Third, the District Court interpreted the Federal Alcohol Administration Act ("FAA Act") in a novel manner. In short, it held for the first time that this 50 year old law is a health statute. The statutory provision in question, 27 U.S.C. § 205(e)(2), directs the Secretary of the Treasury to prescribe such regulations as will provide the consumer with adequate information as to the identity and quality of products, the alcoholic content, and the manufacturer or bottler. The statute does not require complete contents disclosure or mention health considerations as opposed to other considerations, but leaves it up to the Secretary to define what is "adequate." The statute has been in existence since 1935 without the labeling regulations now required by this Court. The District

Court's interpretation represents a significant break from the previous judicial treatment of the FAA Act by this and other courts. See, e.g., Wawszkiewicz v. Department of Treasury, 670 F.2d 296 (D.C. Cir. 1981); Taylor Wine Co. Inc. v. Department of Treasury, 509 F. Supp. 792, 794 (D.D.C. 1981); Gibson Wine Co. v. Snyder, 95 F. Supp. 145 (D.D.C. 1950), aff'd, 194 F.2d 329 (D.C. Cir. 1952). Indeed, in Wawszkiewicz v. Department of Treasury, 480 F. Supp. 739 (D.D.C. 1979), rev'd in part on other gr'ds, 670 F.2d 296 (D.C. Cir. 1981), this Court and the District Court rejected an attempt to require complete contents labeling for varietal wines.

Fourth, the District Court's order that ingredient labeling regulations be put into effect runs counter to two explicit findings by BATF that such regulations are not necessary or appropriate. BATF reached this conclusion in 1975 after a thorough study of proposed regulations which were substantially identical to those which are the subject of this litigation, and after consideration of the views of industry representatives, consumer groups and non-industry experts. 40 Fed. Reg. 52,613 (1975). It reached the same conclusion in 1981 when it rescinded the previously promulgated rules. 46 Fed. Reg. 55,094 (1981). Thus, there is considerable support in the administrative record, both from the 1975 proceedings and from the 1981 rulemaking, for the proposition that ingredient labeling is unnecessary, undesireable, and not in the public interest. Cf. Professional Drivers Council v. Bureau of Motor Carriers Safety, No. 81-2283, slip op. at 13-14 (D.C. Cir. April 26, 1983) (Bureau's decision to terminate rulemaking proceedings after ten years of study and consideration of the issues was a rational decision). Indeed, a prior district court decision approved a similar administrative decision to withdraw proposed mandatory ingredient labelng rules. *See* *Brown-Forman Distillers Corp.* v. *Matthews*, 435 F. Supp. 5, 17 (W.D. Ky. 1976).[n]

Conclusion

As this Court stated in *Holiday Tours*:

> An order maintaining the status quo is appropriate when a serious legal question is presented, when little if any harm will befall other interested persons or the public and when denial of the order would inflict irreparable injury on the movant.

Washington Metropolitan Area Transit Comm'n v. *Holiday Tours, Inc.*, 559 F.2d at 844. The instant case presents just such a situation. The equities presented herein strongly support the relief requested of this Court.

For the foregoing reasons, DISCUS respectfully requests that this Court grant a stay of the District Court's order of February 8, 1983 pending a decision on the appeal of that order.

Respectfully submitted,

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Attorneys for Intervenor-
Defendant DISCUS

Washington, D.C.
June 24, 1983

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[n] The court in *Brown-Forman* stated that BATF's original consideration and rejection of ingredient labeling of alcohol beverages demonstrated that "BATF has over the years been diligent in regulating the labeling of alcoholic beverages; and this diligence was also demonstrated in the manner in which BATF considered the question of ingredient labeling for alcoholic beverages." 435 F. Supp. at 17.

CERTIFICATE OF SERVICE

I, ROBERT G. BERGER, hereby certify that I have on this 24th day of June, 1983, caused to be hand-delivered to Bruce Silverglade, Esq., Center for Science in the Public Interest, 1755 S Street, N.W., Washington, D.C. 20009 and to all other counsel of record a copy of the foregoing MOTION FOR STAY PENDING APPEAL.

Robert G. Berger

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CENTER FOR SCIENCE IN THE PUBLIC INTEREST, *et al.*,

Plaintiffs,

v.

DEPARTMENT OF THE TREASURY, *et al.*,

Defendants.

Civil Action No. 82-610

FILED
FEB 9 1983
JAMES F. DAVEY, Clerk

ORDER

Upon consideration of the parties' cross-motions for summary judgment, the memoranda, affidavits and other papers filed, and the entire record herein, it is by the Court this 8th day of February, 1983,

ORDERED that plaintiffs' motion be and the same hereby is granted, and it is

ORDERED that the final rule issued by the Department of the Treasury on November 6, 1981 (46 Fed. Reg. 55093) is vacated; and it is

FURTHER ORDERED that within thirty (30) days of the date of this order the Department shall announce the new date upon which T.D. ATF-66 will be mandatory, the new date not to be any later than one year from the date of this order.

J. H. Pratt
John H. Pratt
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CENTER FOR SCIENCE IN THE)
PUBLIC INTEREST, et al.,)
)
Plaintiffs,)
)
v.) Civil Action No. 82-610
)
DEPARTMENT OF THE TREASURY,)
et al.,)
)
Defendants.)

FILED
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MEMORANDUM ORDER

Plaintiffs, the Center for Science in the Public Interest (CSPI), a consumer health organization, and two individual consumers brought suit under the Federal Alcohol Administration Act and the Administrative Procedure Act against the Department of the Treasury (the Department) for rescinding alcoholic beverage ingredient disclosure regulations.[1] These regulations, promulgated in 1979, were designed to inform consumers, especially those with allergies, of the contents of alcoholic beverages. Defendant Wine Institute was permitted to intervene in support of the Department's decision to rescind and Banfi Products Corporation filed a brief as *amicus curiae* in support of plaintiffs' position. The case is now before us on the parties' cross-motions for summary judgment.

I. History of the Action

A. Statutory Background

The statutory authority for the Treasury Department's regulation of alcoholic beverages [which it exercises through the Bureau of Alcohol, Tobacco, and Firearms (BATF)], is the Federal Alcohol Administration Act, 27 U.S.C. § 201 *et seq*. (1976) (the Act). The Act, originally passed in 1935, directs the Secretary of the Treasury to prescribe regulations

> . . . with respect to packaging, marking, branding, and labeling and size and fill of container (1) as will prohibit deception of the consumer with respect to such products or the quantity thereof and as will prohibit, irrespective of falsity, such statements relating to age, manufacturing processes, analyses, guarantees, and scientific or irrelevant matters as the Secretary of the Treasury finds to be likely to mislead the consumer; (2) as will provide the consumer with adequate information as to the identity and quality of the products, the alcoholic content

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[1] T.D. ATF-66 issued June 13, 1980.

> thereof . . . the net contents of the package, and the manufacturer or bottler or importer of the product. . . .

27 U.S.C. § 205(e)(1976).

At the time the Act was passed, the Director of the Federal Alcohol Control Administration, predecessor of BATF, explained the congressional intent of Section 205(e):

> Now, the provisions of this bill show that the purpose was to carry that regulation into certain particular fields in which control of interstate commerce in liquors was paramount and necessary . . . .
>
> These regulations were intended to insure that the purchaser should get what he thought he was getting, that representations both in labels and advertising should be honest and straightforward and truthful. They should not be confined, as the purefood regulations have been confined, to prohibitions of falsity, but they should also provide for the information of the consumer, that he should be told what was in the bottle, and all the important factors which were of interest to him about what was in the bottle.

HEARINGS ON H.R. 8539 BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, 74th Cong, 1st Sess. 10 (1935)(statement of Joseph H. Choate).

On February 25, 1979, BATF, in order to implement its statutory mandate, published several proposed regulations calling for ingredient labeling in the Federal Register. Congress was aware of BATF's decision. In 1979, after the BATF announcement, the House Committee on Appropriations attempted to prohibit the expenditure of funds in connection with the promulgation of such regulations. H.R.REP.NO. 248, 96th Cong., 1st Sess. 10 (1979). The Senate Committee on Appropriations, however, supported the proposed regulations:

> On February 2, 1979, the Bureau published in the Federal Register several proposed regulations which would require the ingredient labeling of alcoholic beverages. The Committee believes that these regulations, accommodated for the substantive points raised by the industry and other interested parties, should be of benefit to the public.

S.REP.NO. 299, 96th Cong., 1st Sess. 12 (1979).

The Conference report reflects that the limiting amendment proposed by the House was rejected.

> Amendment No. 7: Deletes language proposed by the House and stricken by the Senate which prohibits the use of funds for issuing or carrying out proposed rules on labeling of wine, distilled spirits and malt beverages.

H.R. CONF. REP. No. 471, 96th Cong., 1st Sess 6 (1979).

B. Promulgation of the Ingredient Labeling Regulation

BATF has been considering ingredient labeling proposals for the last decade. It first proposed such regulations in 1974 but no final rule was promulgated at that time. The regulations which were proposed in February, 1979 and are the subject of this suit were published and a final rule was issued on June 13, 1980.[2] BATF explained that:

> This rule requires ingredient disclosure on labels of wine, distilled spirits, and malt beverages. These regulations, however, provide an exception to this requirement. Under this exception the ingredient list will not be required to appear on the label when the producer, bottler, or importer: (1) elects to make an ingredient list available upon request; (2) places a statement on the front label or a separate strip label notifying the consumer of the availability of an ingredient list and provides the name and, somewhere on the label, a full mailing address in the United States where such an ingredient list can be obtained upon request; and (3) does not place a statement on the label which could be misconstrued to be an ingredient list. This exception gives industry maximum flexibility to provide ingredient information at minimum cost. At the same time, it provides consumers who have the need or desire to avoid various ingredients a means to do so, thus meeting the objective of the regulatory proposal. Because of special health problems, this rule also mandates the disclosure on the label, in all instances, of the presence of FD&C Yellow No. 5 whenever it is used in a product.

45 Fed. Reg. 40538 (1980).

In its final publication on June 13, 1980 in the Federal Register, BATF devoted six pages to explaining its reasons for issuing the regulations. It detailed the steps of its Regulatory Analysis, which included an outline of the possible steps that could be taken to deal with the problem of ingredient disclosure, a consumer poll, and a cost-benefit study conducted by the BDM Corporation, a private consultant hired by BATF. The Bureau also received 1,873 comments in response to Notice No. 314 from consumers, special interest groups, industry members, doctors, government agencies, and members of Congress.

The BDM study emphasized that widely different conclusions could b reached concerning the value of ingredient labeling, depending on the assumptions used. Major findings of the study included:

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[2] T.D.ATF-66 became effective on October 13, 1980, but was not made mandatory until January 1, 1983.

> 2. Estimates of expected costs of mandated ingredient labeling to industry and the Government based on the information submitted, range between a low of $12 million per year to almost $150 million per year. The major factors that contribute to this range of estimates are the use of a back label, advertisement costs, and markups that might be applied by the industry at different points in the distribution channel. The 'advertisment costs' were submitted directly to BDM by one winery after the comment period and from this one submission BDM estimated a total annual $25 million advertising cost for the entire wine industry.
> 3. Start-up costs amount to approximately $18 million for the entire industry if no additional back labels are used; if additional back labels are used by all producers not presently using back labels, the 'total potential investment cost for the three industries, as reported by the industries, are in excess of $35 million.'
> 4. BDM found 'strong evidence' in the medical research literature that indicated 'ingredients used in alcoholic beverages can cause adverse health effects in humans.' BDM found that while most of the effects are not necessarily severe, some are severe. The study also reports that adverse effects are 'not limited to allergic reactions.' It is impossible, however, to determine exactly either how many people are affected (the range BDM gave is anywhere from 475,000 to 1,700,000) or how much money in health costs could be saved if ingredients were listed. (A wide range of estimates ranging from approximately one-half million dollars to four hundred million dollars was considered possible, depending on which assumptions were considered the most appropriate.)

45 Fed. Reg. 40539 (1980).

It is important to note that the BDM study did not contemplate the option that the final regulations gave to manufacturers to provide ingredient lists to consumers upon request and to make known the availability of such lists by stating on the label the name and address where such lists can be obtained. The study also did not address the health benefits of ingredient labeling other than prevention of allergic reactions.[3/]

Based on the BDM study, the poll of consumers, and the comments and studies submitted in response to the proposed rulemaking, the Treasury Department stated that it was

> . . . convinced that the disclosure of ingredients used in the production of alcoholic beverages is of real value. This disclosure will provide consumers with adequate information

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[3/] As plaintiff indicates, "The medical literature contains at least one case in which doctors plainly stated that they could have saved the lives of their patients who were dying from the effects of cobalt sulfate, a beer foam enhancer, had they known that the additive was in beer consumed by these unfortunate individuals." Plaintiff's Amended Memorandum at 19-20, citing ADMIN. REC., Part II, Vol. D. Comment No. 6000.

> about the identity and quality of the product which will enable a consumer to make an informed choice in the purchasing of alcoholic beverages . . . . However, to minimize the costs while still meeting basic policy objectives, producers, bottlers or importers who elect to make ingredient lists available upon request, notify consumers of their availability, and who avoid implied label statements about ingredients, will not be required to list ingredients on the label.

45 Fed. Reg. 40540 (1980).

C. Rescission of the Regulations

We turn now to the basis for the present litigation.

In the face of this prior record, the Department of the Treasury on May 4, 1981 published another notice of proposed rulemaking, this time notifying the public of its intent to rescind the ingredient labeling regulations. 46 Fed. Reg. 24962 (1981). The one-page notice stated that ". . . the Department has reviewed comments received in response to Notice No. 314, published in the Federal Register on February 2, 1979 [44 FR 6740]. As a result of that review, the Department is proposing to rescind (the regulations)." 46 Fed. Reg. at 24962.

The review of the comments and regulations purportedly was prompted by Executive Order No. 12291, 46 Fed. Reg. 13193 (1981), which " . . . directs each Federal Agency to review existing regulations with the aim throughout the Government of maximizing the benefits to society while at the same time imposing the least burden to achieve these benefits." Defendants' Statement of Material Facts at 2. The Department, "as a result of the review of existing regulations called for by Executive Order 12291, . . . concluded that (T.D. ATF-66) is not in accord with the President's mandate," 46 Fed. Reg. 24963 (1981), and thus proposed rescission.

On November 6, 1981, BATF announced its final rule rescinding the June 13, 1980 regulations. The basic reasons for reversing its previous decision were set out in two paragraphs which, in summary state that: (1) The Department has concluded, within its discretionary authority under the Act, ". . . that ingredient labeling regulations would result in increased costs to consumers and burdens on industry which are not commensurate with the benefits which might flow from the additional label information," and (2) the Department further concluded ". . . that ingredient labeling would not result in an appreciable benefit to consumers when compared to the existing label information requirements and standards of identity." 46 Fed. Reg. 55094 (1981).

The notice also mentioned that the regulations were incompatible with United States international commitments and E. O. 12291.

II. Standard of Review

A. The Case for Heightened Scrutiny

Plaintiffs argue that Treasury's decision to rescind the regulations is substantively invalid under the Act and procedurally invalid under the informal rulemaking requirements of the Administrative Procedure Act. In considering these claims, we are well aware of the limited role a court traditionally plays in reviewing agency decisions. It "must consider whether the decision was based on a consideration of the relevant factors . . . . Although this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency." Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971). Thus, an agency action in most cases will be held unlawful only if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A)(1976).

In the case before us, however, we are confronted with a factual record which may very well justify a higher standard of review. As the plaintiffs argue, where the health of the public is at issue, "close scrutiny of administrative action is particularly appropriate. . . Wellford v. Ruckelshaus, 439 F.2d 598, 601 (D.C.Cir. 1971). Defendants apparently concede this but argue instead that the disclosure requirements of the Act were enacted in order to provide information to the consumer, not to protect the consumer's health. Defendants' Opposition to Plaintiffs Motion at 2. We submit that merely providing information is in and of itself not the reason for the Act. Rather, Congress wanted consumers to have information for a clear purpose - to allow them to make decisions that might affect their health. See C. SANDS SUTHERLAND'S STATUTORY CONSTRUCTION § 71.03 (4th ed. 1974).

A second justification for subjecting Treasury's decision to rescind to greater scrutiny is that this case involves final regulations which were rescinded a little more than a year after being promulgated. In our judgment, this fact alone is a signal that careful examination is required. Here, the regulations were issued by one administration and shortly thereafter rescinded by the next under the purported aegis of Executive Order 12291, the President's mandate on less government regulation. Although we recognize that basic political differences between administrations may be manifested in the way in which they

choose to exercise their discretionary functions, "sudden and profound alterations in an agency's policy constitute 'danger signals' that the will of Congress is being ignored." State Farm Mutual Auto Insurance v. Department of Transportation, 680 F.2d 206, 221 (D.C.Cir.) cert. granted, 103 S. Ct. 340 (1982). Thus, the Court of Appeals in this circuit has stated that ". . . where policy has been altered, the court should be satisfied both that the agency was aware it was changing its views and has articulated permissible reasons for that change, and also that the new position is consistent with the law." N.A.A.C.P. v. F.C.C., 682 F.2d 993, 998 (D.C.Cir. 1982).[4] Here, it is undisputed that the agency was well aware that it was reversing its prior policy. Two ultimate questions, i.e., whether the change was supported by explicit, permissible reasons and whether it was in accordance with the law, remain to be determin
In summary, we conclude that a greater degree of scrutiny is required in the case of an action which reverses prior policy than for an action setting policy for the first time.

B. Review of the Decision to Rescind T. D. ATF-66

Plaintiffs specifically object to the rescission on three levels. First, they argue that the decision was illegal because Treasury's actions taken pursuant to Executive Order No. 12291 conflicted with its statutory mandate under the Act. Secondly, plaintiffs claim that Treasury violated the substantive requirements of the Administrative Procedure Act because it failed to explain why it reversed its prior conclusion that the rule was cost-beneficial and necessary. Lastly, plaintiffs allege that Treasury did not act in accordance with the procedural aspects of the Administrative Procedure Act. We consider each of these contentions.

1. Application of E.O. 12291 to Regulations Issued Pursuant to FAA Act § 205(e)

Plaintiffs contend that Treasury's application of E.O. 12291 to the ingredient labeling regulations violated its statutory mandate.[5]

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[4] Defendants argue that the cases cited by plaintiffs on this issue "typica involve a change in a long-standing policy or interpretation by an agenc upon which others had come to rely, rather than a change in regulations (which had never gone into effect). . . ." Defendants' Opposition at
We agree with plaintiff's response that "[J]ust as in the present case, the court in State Farm was responding to the rescission of a final rule that had become effective, but that had not yet become mandatory." Plai tiff's Rebuttal Memorandum at 5. See also 27 C.F.R. Parts 4, 5 and 7 (1981)(codification of the regulations as a final rule).

[5] Plaintiffs do not argue that E.O. 12291 is inherently illegal, but that the manner in which Treasury applied it was illegal. The Executive Ord directs the departments to consider costs and benefits "to the extent permitted by law." In this case, plaintiffs argue, the FAA Act preclud the agency from considering costs to the industry as an overriding fact

The order is of general application and requires all agencies to consider the societal costs and benefits of all regulations, "taking into account the condition of the particular industries affected by the regulations. . . 46 Fed. Reg. 13193-94 (1981). The FAA Act directs the Secretary of the Treasury to prescribe regulations "as will provide the consumer with adequate information as to the identity and quality of the products." Plaintiffs believe that Congress in the statute has made its policy choice in favor of providing information to the consumer and that Treasury may not now change the balance to give controlling weight to other interests, such as cost to the industry, which it believes to be equally important.

Defendants respond that Congress itself took costs into account when considering different regulations under the FAA Act. Defendants' Opposition to Plaintiffs' Motion at 3. The agency further justifies its position by citing *Waskiewicz v. Dept. of Treasury*, 670 F.2d 296, 302 (D.C.Cir. 1981), in which the Court of Appeals implicitly approved Treasury's consideration of the costs of certain labeling regulations. We accept the eminent good sense of this decision because costs are always a factor in deciding the feasibility or practicality of a regulation.

Whatever the consideration given to costs and benefits, however, an agency may not substitute its policy judgment for the judgment that has already been articulated by Congress. In this case, Congress announced that the Department had the authority to issue regulations requiring producers of alcoholic beverages to adequately inform the consumer of the identity and quality of the products, the alcoholic quantity thereof, the net contents and the name of the bottler. It did not condition such a grant of authority with a proviso that the regulations could be withdrawn if the costs to the industry turned out to be too high.

The Supreme Court in *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971), addressed a similar question of agency cost consideration. In that case, the Department of Transportation decided to build a highway through a public park, even though the statute prohibited federal construction of highways through public parks if a "feasible and prudent" alternative route existed. The Secretary decided to proceed with the project after taking into account the cost of alternative routes, safety considerations, and other factors. The Court invalidated the agency's action, saying that "Congress clearly did not intend that cost and disruption of the community were to be ignored by the Secretary. But the very existence of the statutes indicates that protection of parkland was to be given paramount importance." 401 U.S. at 412-13. There, as here, Congress has previously set the legislative agenda. Just as preservation of parkland was paramount under the Federal-Aid Highway Act, "control of interstate commerce in liquors was paramount and necessary" to protect consumers under the FAA Act.

We are further convinced that Treasury's decision conflicts with its statutory mandate in light of the congressional decision not to limit funds for the promulgation of ingredient-labeling regulations. Supra, at page 3. Congress considered the 1979 decision to promulgate ingredient-labeling regulations, and by rejecting amendments directed against such regulations, affirmed its original policy choice. See National Automatic Laundry and Cleaning Council v. Schultz, 443 F.2d 689, 706 (D.C.Cir. 1971). Thus, the cost to the industry in Congress' view did not outweigh the basic belief that consumers have a right to know the contents of alcoholic beverages. In short the broad thrust of Executive Order No. 12291 provides an insufficient basis for the defendants to disregard their statutory duties imposed by Section 205(e), reflecting Congressional policy which was reaffirmed as recently as 1979.

2. Review of the Department's Decision to Rescind Under the Administrative Procedure Act

Even if the rescission did not violate the Department's statutory mandate, plaintiffs argue that it violated the substantive requirements of the Administrative Procedure Act. They claim that defendants did not explain why they reversed their prior decision that the regulations were cost-beneficial and necessary to protect the health and welfare of consumers.

Defendants finalized the decision to rescind in the November 6, 1981 notice, 46 Fed. Reg. 55093 (1981). Supra, at page 7. The notice contains a summary of the comments received after Treasury announced that it was proposing rescission,[6] and sets out four reasons for rescission: (1) the ingredient labeling regulations did not meet the criteria of E.C. 12291; (2) the regulations were not in keeping with United States' international commitments; (3) the costs to consumers and the industry were greater than the benefits which would be derived from the additional label information, and (4) existing label information is adequate. 46 Fed. Reg. 55094 (1981).

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[6] Defendants, in their memorandum supporting their motion, provide an even more detailed description of the comments received, but we are skeptical of the relevance of the comments in light of the fact that the agency di not utilize many of the comments in its reasons for decision. We are also skeptical of using the comments as a type of referendum or head cou on the issue of whether the regulations should be rescinded. First, the agency's role is to use its expertise to carry out the congressional intent. It may use the comments as a source of information, but to rely completely on the comments as a basis for decision renders the administrative process meaningless. Secondly, plaintiffs supply strong evidenc that many of the comments received were part of an industry effort to pa the administrative record. Plaintiff's Rebuttal Memorandum at 13.

We have discussed the first basis for decision, conformance with E.O. 12291, supra. We now deal with the question of whether the other three proffered explanations constitute permissible reasons for change.

(a) The Claim of Adverse Effects on International Commitments

Defendants only reference to international trade in the final notice of rescission is the statement that ". . . the Department has concluded that the regulations were not in keeping with United States international commitments." 46 Fed. Reg. 55094 (1981). The Department provided no explanation in either the notice of the proposed rescission or in the notice of rescission itself of why it believed that the regulations would violate international commitments.

Defendants in their brief note certain comments submitted to BATF that related to the exporting and importing of alcoholic beverages. This does not suffice as a substitute for the required reasoned explanation by the agency. The agency must do more than point to comments that allege that the regulations will have disastrous effects if implemented. They must supply a reasoned explanation for the decision and why they were convinced by those comments rather than the comments expressing the opposite view. This is especially necessary in a case such as this where the conflicting view was adopted just one year earlier. See 45 Fed. Reg. 40540 (1980). From the initial announcement in the Federal Register,[7] it appears that Treasury had made a decision to rescind. Its later recital of comments and conclusions coincided with this prior decision. Without a more detailed justification for this sharp reversal, this, at least on the surface, represents a good example of arbitrary and capricious decision-making.

(b) The Claim That Costs to Consumers and the Industry Outweigh the Benefits

A third rationale for the decision to rescind was that ". . . ingredient labeling regulations would result in increased costs to consumers and burdens on industry which are not commensurate with the benefits which might flow from the additional label information." 46 Fed.

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[7] In the text of their notice of proposed rulemaking, defendants indicate that they were rescinding the Ingredient Disclosure Rule pursuant to E. O. 12291: "As a result of the review of existing regulations called for by Executive Order 12291, the Department has concluded that T.D. ATF-66 [the Ingredient Disclosure Rule] is not in accord with the President's mandate." (emphasis supplied). 46 Fed. Reg. 24963 (1981).

Reg. 55094 (1981). Again, defendants were required to provide a reasoned explanation for their action and not simply state that they disagreed with the conclusions the Department reached the previous year.

It is possible that less of a showing is necessary if the previous decision had been without adequate explanation or was unreasonable on its face. To the contrary is true. The Department's initial decision to issue the regulations was the result of years of research and careful consideration, a fact evidenced by the June 13, 1980 notice, 45 Fed. Reg. 40583 (1980). It was predicated on an impressive factual record, which documented the range of costs to industry and the savings in health costs to consumers.

In addition to the monetary costs and benefits, the BDM study estimated that the number of people allergic to the ingredients in alcoholic beverages ranged anywhere from 475,000 to 1,700,000. The Department recogniz that the precise level of harm to consumers could not be established, but stated its conclusion "that consumers who are allergic to certain ingredients generally should be able to find out, whether from the label or some other source, if those ingredients are used in alcoholic beverages so that they can avoid the possibility of adverse reactions if they so choose." 45 Fed. Reg. 40540 (1980). The agency thus realized that when directed to issue regulations related to the public health and consumer protection, it could not base its conclusions solely on monetary calculations, but that it must also recognize the intangible benefits flowing from such regulations. Based on the information that it had gathered, Treasury in 1980 decided that the advantages of ingredient labeling outweighed the costs. Even though it believed that regulations which required ingredients to be listed on the bottle were justified on a cost-benefit basis, BATF, in an effort to take into account some of the comments submitted by members of the industry, provided an alternative to ingredient labeling:

> . . . to minimize the costs while still meeting basic policy objectives, producers, bottlers, or importers who elect to make ingredient lists available upon request, notify consumers of this availability, and who avoid implied statements about ingredients, will not be required to list ingredients on the label.

45 Fed. Reg. 40540 (1980).

Defendants did not consider this address label option in either the notice proposing rescission of T.D. ATF-66 or in the final notice of rescission. When the Department issued the regulations in 1980, it structur an alternative in an effort to provide consumers with information at minimal cost. The Department now says that the regulations imposed too great a burden on the industry but makes no attempt to assess the marginal cost of the address label option. In our judgment, it acted in an arbitrary and capricious manner, especially in light of industry comments expressing the view that such an option would be an acceptable alternative to ingredient labeling. 45 Fed. Reg. 40583 (1980).[8]

We are convinced that the existence of the address label option undermines the cost arguments advanced by defendants for two reasons. First, as defendants themselves noted, ". . . allergic consumers are presently furnished an address where they can write for information since present regulations require that an address appear on the bottle."[9] Opposition of Federal Defendants to Plaintiffs' Motion for Summary Judgment at 7. Secondly, industry members have indicated that they already respond to requests for ingredient information, so that a formal requirement that they must respond would theoretically only codify existing practice.

Because regulations already require some address to be printed on all alcoholic beverage containers and because industry members contend that they presently respond to consumer requests, defendants are faced with the heavy burden of demonstrating that the costs of compliance with the regulations require their rescission. Not one sentence in the notice proposing rescission or in the rescission itself addresses the costs of the labeling option.[10]

In sum, we are persuaded that Treasury has not met its burden of providing a reasoned explanation for its decision on the ground that the costs of the regulations outweigh the benefits.

(c) The Claim that Existing Label Information is Adequate

Defendants asserted in the notice of rescission that current "standards of identity" provide sufficient information to the consumers of alcoholic beverages, and that all the substances used in alcoholic beverages have received F.D.A. approval. Standards of identity, according to the Department, "generally identif[y] the basic agricultural ingredients and further, [set] forth parameters of production and alcoholic content." 46 Fed. Reg. 55094 (1981).[11]

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[8] It is also interesting to note that all of the arguments in defendants' briefs, with the exception of the supplemental brief we requested specifically addressing the issue, were directed toward that part of the regulation which required ingredient labeling. Defendants have made no effort to show that the regulations, including the address label option, were not cost-beneficial or reasonable under the Act.

[9] The extant regulations only require a city and state address, however, and not a street address or zip code. The rescinded regulations would have required the entire address.

[10] Plaintiffs demonstrate that the new regulations are necessary because they require that the address label contain the words "For information about this product, write:" before their mailing addresses, and bec although industry members say they respond to requests, there is nothi that requires them to respond. Plaintiff's Supplemental Brief at 4-5.

This argument, while having a certain superficial appeal, is not convincing in the factual context of this case. Defendants fail to explain why the Department is satisfied that the standards of identity and F.D.A. approval of ingredients sufficiently protect consumer interests, when just a year earlier, it made the determination that these measures did not provide "adequate information" as required by the statute.

On the other hand, plaintiffs advance several reasons to doubt defendants' conclusory statement that ingredient labeling "would not result in an appreciable benefit to consumers when compared to the existing label information requirements and standards of identity." 46 Fed. Reg. 55094 (1981). First, standards of identity exist only for wine and distilled spirits, not for beer or other malted beverages. Secondly, plaintiffs have supplied a list of the additives that alcoholic beverages may contain, which demonstrate that although the standards of identity are required to set forth the basic agricultural ingredients found in alcoholic beverages, they do not disclose "any of the hundreds of possible other foam enhancers, stabilizers, anti-oxidants, chill-proofing agents, preservatives, coloring agents, or artificial flavors which may be used in the beverages and which consumers need to know for health reasons." Plaintiffs' Amended Memorandum at 26, Pltfs' Ex. F.

Defendants' misplaced reliance on standards of identity and F.D.A. approval of ingredients as a way to protect consumers is illustrated by their approach to FD&C Yellow No. 5, a color additive used in alcoholic beverages, to which plaintiffs make specific reference. There is "mounting evidence of allergic-type reactions to FD&C Yellow No. 5," 44 Fed. Reg. 37212 (1979), but the use of the additive is not reflected in standards of identity and the Department would not now require that notice of its use in a product be disclosed on the container's label. This is a matter of particular concern since the F.D.A. recently amended its regulations and now allows the additive to be used only if the food manufacturers disclose the existence of the additive on the label. 44 Fed. Reg. 37212 (1979). For Treasury to contend that the new regulation was unnecessary because the ingredients had met F.D.A. approval is plainly misleading, since that approval was explicitly conditioned upon disclosure. The F.D.A. has recognized that certain substances are not universally safe, and that there is sufficient risk associated with their use to compel food manufacturers to disclose the presence of such additives in their products.

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[11] Standards of identity for wine and distilled spirits are codified at 27 C.F.R. §§ 4.2, 5.22 (1982).

We are convinced that the Department of the Treasury has not adequately justified its decision to rescind the ingredient labeling regulations. We are cognizant of the deference which courts traditionally accord to the decisions of administrative agencies. If we were to approve this decision, however, we would be ignoring our obligations under the Administrative Procedure Act and acting as little more than a "rubber stamp." We are required to reject agency actions such as this which are ill-considered and superficially explained.

3. Review of Treasury's Actions Under the Procedural Requirements of the Administrative Procedure Act

In view of the disposition previously indicated it is not necessary to consider plaintiffs' procedural objections at any length. They deserve, however, more than passing reference. Basically, plaintiffs allege that they were denied a meaningful opportunity to be heard because defendants had succumbed to political pressure and had decided to rescind the rules even before comments were solicited. They also contend that a number of ex parte contacts occurred which should have been logged and disclosed in order to provide a complete record of the rulemaking. We do not think that these are valid objections to the agency's conduct.

It is important to note that this is not an adjudicative decision by the agency, nor is it a decision that can only be made after a formal rulemaking. As an example of informal rulemaking, our concern for undisclosed and unrecorded contacts in this context is less than in the other two more sensitive proceedings.

Considering the ex parte contacts allegation specifically, plaintiffs have failed to convince us that 5 U.S.C. § 553 (1976) requires that an agency disclose and log all contacts when it is engaging in informal rulemaking. The rule simply allows interested parties to submit material for the agency's consideration - it does not require that the agen record all the information it receives. Plaintiffs cite Sierra Club v. Costle, 657 F.2d 298, 403 for the proposition that an agency must disclose all ex parte contacts. The case concerns the Clean Air Act Amendments, however, not the A.P.A., and it only held that the Environmental Protection Agency should use its discretion to determine when oral communications had been of central importance to the decision and should thus be recorded. Nothing in that case requires disclosure of all contacts in this case.

We are similarly convinced that no procedural flaws existed as a result of the congressional communications. We know that there are some instances in which the congressional interference with agency action has been so great as to taint the agency's decision, but in our view, letters and phone calls from congressmen urging rescission do not constitute this sort of interference. It can be plausibly argued that communications from congressmen on behalf of constituents are part of any congressman's duty of proper representation. Plaintiffs cite no case, and we know of none, in which an agency decision was invalidated because the agency had received letters from congressmen arguing for a certain outcome.

CONCLUSION

Because this Court finds that the Department of the Treasury has violated both its statutory mandate under the Federal Alcohol Administration Act and the Administrative Procedure Act, we hold invalid and set aside its decision to rescind the ingredient labeling regulations contained in T.D. ATF-66.

An order consistent with the foregoing has been entered this day.

J. H. Pratt
John H. Pratt
United States District Judge

February 8th, 1983.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CENTER FOR SCIENCE IN THE PUBLIC INTEREST, *et al.*,

Plaintiffs,

v.

DEPARTMENT OF THE TREASURY,

Defendant,

DISTILLED SPIRITS COUNCIL OF THE UNITED STATES, INC.,

Intervenor-Defendant,

WINE INSTITUTE,

Intervenor-Defendant.

Civil Action No. 82-.10

FILED
JUN 20 1983
JAMES F. DAVEY, Clerk

ORDER

Upon consideration of the motions of intervenor-defendants for a stay of this Court's Order of February 8, 1983, it is hereby, this 20th day of June, 1983,

ORDERED that the motions are denied.

J. H. Pratt
John H. Pratt
United States District Judge

DECLARATION OF RUSSELL W. SHANNON, SECRETARY AND GENERAL COUNSEL, DISTILLED SPIRITS COUNCIL OF THE UNITED STATES, INC.

I, RUSSELL W. SHANNON, declare and state as follows:

1. I am Secretary and General Counsel of the Distilled Spirits Council of the United States, Inc. ("DISCUS"), the movant for a stay pending appeal in this action. I submit this declaration in support of that motion to show that the members of DISCUS will suffer serious and irreparable injury for which there is no adequate remedy at law in the absence of a stay of the February 8, 1984 mandatory date for the ingre-

dient labeling regulations at issue in this action. I am fully familiar with the facts stated herein.

2. DISCUS is a corporation duly organized under the laws of Delaware and has its principal place of business in Washington, D.C. It is the principal trade association of the distilled spirits industry. Its members produce and import approximately 90% of the distilled spirits sold annually in the United States. The estimated retail value of distilled spirits sold in the United States during 1981 was $20.4 billion. For the twelve months ended September 1982 the federal government alone realized $3.6 billion in revenues from the distilled spirits industry. DISCUS is an organization long concerned with alcohol-related problems and is dedicated to their solution.

3. Timely compliance with the February 8, 1984 mandatory date for the ingredient labeling regulations of T.D. ATF-66 will require the entire industry to act immediately. Orderly implementation of the ingredient labeling rule normally would require approximately (15) months. This would allow for the exhaustion of existing supplies of bottles and labels. It would also allow for the design, production and inventorying of large numbers of new labels for thousands of brands and bottle sizes. In some cases the designing of new bottles will involve the art department, advertising department, marketing department, and production department of all spirits bottlers and importers. I also believe this 15-month period would allow for all necessary approvals by the Bureau of Alcohol, Tobacco and Firearms ("BATF"), but we cannot be certain.

4. DISCUS previously has prepared estimates of the cost of implementation of the ingredient labeling rule. The cost computed for distilled spirits industry start-up in 1980-81 were as follows. Labels for 16,000 brands and/or sizes would have been redesigned at an estimated cost of $11.34 million. Testing for correct ingredient determination would have cost $260,000. Most of the 360 bottling lines in operation

in that year would have required either modification or new equipment at an estimated cost of $2.51 million. New bottle molds for containers whose present design would not have permitted an additional label would have been $920,000. Obtaining Government approvals for label changes would have cost $340,000. Initial inventories of new labels in the first year would have cost an estimated $6.18 million. The total estimated initial start-up cost in 1980-81 would have been $23.88 million for the distilled spirits industry alone. These estimates do not include the wine or malt beverage industries. Nor do these estimates include the lost value of those labels and bottles which will still be inventoried and yet be unusable as of, and even prior to, the February 8, 1984 mandatory date. All told, estimated costs will not be less, and will probably be greater, today than they were in 1980-1981.

5. Many members of DISCUS are extensively involved in importing distilled spirits into the United States. Approximately 30% of the spirits sold in the United States are imported from abroad. The international nature of their businesses will complicate attempts to comply with the regulations and require that immediate preparations be made. In particular, imports will require much longer lead times for compliance due to the need for preparation for export and actual shipping; language barriers and other technical difficulties; and lack of trained scientific personnel available to travel overseas to explain the rules to foreign producers and ensure compliance by them. It should be noted that foreign laws and foreign understandings concerning the definition of natural, as opposed to artificial, flavorings are completely different than counterpart American laws and understandings.

6. The distilled spirits industry must begin to incur the costs associated with the ingredient labeling rule immediately because fully implementing the necessary production and administrative changes will require at a minimum, with industry members working at an accelerated, crisis pace, all of the time remaining until February 8, 1984.

7. Thus, extensive changes will have been implemented and large costs incurred prior to the decision of the court of appeals. If this Court's decision is reversed or modified on appeal, enormous effort and large sums of money will have been expended needlessly. DISCUS' members will have no way of recovering these costs.

I declare under penalty of perjury that the foregoing is true and correct to the best of my personal knowledge.

Dated: June 10, 1983

Russell W. Shannon

DECLARATION OF CARTER HUNT

I, Carter Hunt, declare and state as follows:

1. I am, and since December 1979, have been the Vice President & General Production Manager of Hiram Walker & Sons, Inc. Hiram Walker & Sons, Inc. is in the business of making and bottling distilled beverage alcohol products.

2. I have reviewed the rule issued by the Department of the Treasury on June 13, 1980 as T.D. ATF-66, which requires ingredient labeling or address listing for obtaining ingredient information. The Department of the Treasury has now set February 8, 1984 as the date on which the ingredient labeling rule becomes mandatory. In order to be in compliance with the rule by that date, implementation by my company will have to begin at once. This will cause us to incur economic costs and make production changes which are certain, great, and immediate.

3. A rule that all spirits bottled after February 8, 1984 carry the new label information will require immediate action. The design, production, and inventorying of labels for 316 bottle sizes and brands which we either bottle, purchase, or have control over, and in some cases the designing of new bottles to accomodate the altered size or number of labels will involve the art department, advertising department, marketing department, and production department. Use of the optional address statement also would create considerable label design problems, since the regulations regarding this option are more limiting. For example, the optional address statement must be in type size twice as large as ingredient information and must be on the front of the bottle. Sections 5.33 (b) (4) & (5), 5.39a (a) (2) (ii). Since doubling the size of the type increases both the width and height of each letter, considerable label space might be needed, thus necessitating a redesigned label.

4. After labels are designed and approved by the company, they will have to be submitted to the Bureau of Alcohol, Tobacco and Firearms for approval.

Since the Bureau of Alcohol, Tobacco and Firearms will be inundated with thousands of Form 1649 or Form 1649 Supplemental applications for approval of new labels, as required by Section 5.39a, there will be very lengthy delays in obtaining the approval of new labels. We will not be able to order our full complement of initial run labels until our new labels have received approval from the Bureau of Alcohol, Tobacco, and Firearms. Thus, the design and preparation of new labels will have to begin at once to meet a February 1984 effective date.

5. In order to comply with the ruling on the effective date the industry will be going through complete redesign and procurement of labels. There are only a limited number of printing companies which can produce labels of the quality required for distilled spirits products. We order most of our labels through the FLEMING PACKAGING CORPORATION in Peoria, Illinois, which company has all of our plates and designs at their offices and which company is familiar with our whole concept of labeling, including colors and design of labels. Since there are only a limited number of printing companies which specialize in liquor labels, it is doubtful whether these suppliers would be able to accomodate industry-wide orders placed simultaneously. Since the regulation will apply to each product of the entire beverage alcohol industry, orders for printing will have to be submitted in the very near future.

6. Given a mandated date (February 8, 1984) for change to labels complying with the new rule, we anticipate that substantial inventories of existing labels will be rendered obsolete and unuseable. We estimate that labels valued at $275,000 will have to be written off.

7. If it is necessary to enlarge the size of labels in order to meet the information requirement under the new rule, it is conceivable that many of the bottle designs will not accomodate the enlarged labels. It would, therefore, be necessary in such cases to design new bottles and have new bottle molds fabricated to replace those bottles which have a limited smooth surface. In some cases, it may be necessary to have back side labels produced and new bottles may have to be designed to accomodate the placement of labels on the back side. Since there are only a limited number of beverage alcohol bottle manufacturers, our company would have to begin placing orders soon. We typically keep an inventory of empty bottles approximately six (6) months ahead of when they are to be filled.

8. We estimate the cost of redesigning our brand labels to be $210,000. The cost of obtaining label approvals or complying with BATF rules regarding label approval will be approximately $100,000.

9. A limited number of redesign labels will be so changed in size and shape as to require new or reworked labeler change parts, estimated to cost $200,000.

10. Where redesign of the labels requires a change in the size of the label there will be an increase in the cost of the labels. This increase in label cost due to size change is estimated at $15,550 per year.

11. We will begin to incur administrative costs immediately as we redesign labels. New stock numbers must be assigned and our computer data base must be updated; a task force must be set up to develop the ingredient information to be sent to consumers upon request, as this information must accompany application for certificate of label approval for the redesigned labels. We estimate that these administrative costs will be $45,000. In addition, we anticipate a continuing ongoing expense for response to inquiries of about $45,000 per year on the assumption that we will receive an inquiry for one in every 10,000 bottles shipped (0.01%).

I declare under penalty of perjury that the foregoing is true and correct to the best of my personal knowledge.

Dated: May 20, 1983.

CARTER HUNT

County of Sebastian
State of Arkansas

Carter Hunt personally appeared before me this 20th day of May, 1983.

My Commission Expires April 1, 1985

Notary Public

DECLARATION OF THE DISTILLERS COMPANY, LIMITED (DELAWARE)

I, Hugh J. Kelly, declare and state as follows:

1. I am and, since January 1981, have been the Vice President of The Distillers Company, Limited (Delaware). The Distillers Company, Limited is in the business of producing distilled spirits.

2. I have reviewed the rule issued by the Department of the Treasury on June 13, 1980 as T.D. ATF-66, which requires ingredient labeling or address listing for obtaining ingredient information. The Department of the Treasury has now set February 8, 1984 as the date on which the ingredient labeling rule becomes mandatory. In order to be in compliance with the rule by that date, implementation by my company will have to begin at once. This will cause us to incur economic costs and make production changes which are certain, great and immediate.

3. A rule that all spirits bottled after February 8, 1984 carry the new label information will require immediate action. The design, production and inventorying of large numbers of labels for 75 different bottle sizes and brands

and in some cases the designing of new bottles to accommodate the altered size or number of labels will involve the art department, advertising department, marketing department, and production department of spirits bottlers and importers. Use of the optional address statement also would create considerable label design problems, since the regulations regarding this option are more limiting. For example, the optional address statement must be in type size twice as large as ingredient information and must be on the front of the bottle. Sections 5.33 (b) (4) & (5), 5.39a (a) (2) (ii). Since doubling the size of the type increases both the width and height of each letter, considerable label space might be needed, thus necessitating a redesigned label.

4. After labels are designed and approved by the company, they will have to be submitted to the Bureau of Alcohol, Tobacco and Firearms for approval. Since the Bureau of Alcohol, Tobacco and Firearms will be inundated with thousands of Form 1649 or Form 1649 Supplemental applications for approval of new labels, as required by Section 5.39a, there will be very lengthy delays in obtaining the approval of new labels. We will not be able to order our full complement of initial run labels until our new labels have received approval from the Bureau of Alcohol, Tobacco and Firearms. Thus, the design and preparation of new labels will have to begin at once to meet a February 1984 effective date.

5. Following approval by the Bureau of Alcohol, Tobacco and Firearms, we will have to have sufficient labels printed. Unless orders for labels are placed forthwith, a severe label supply problem will arise because of the limited number of companies which print wine and spirits labels. We are aware of only two printing companies from which we could obtain labels. They would not be able to accommodate industry-wide orders placed simultaneously. Since the regulation will

apply to each product of the entire beverage alcohol industry, orders for printing will have to be submitted in the very near future.

6. Many bottle designs will not accommodate labels which are enlarged in order to contain the information required by the rule. New bottles will have to be designed and new bottle molds fabricated to replace those bottles which have a limited smooth surface to which any new, larger, or additional labels would not adhere. In some cases back side labels will have to be produced and new bottles will have to be designed and molds made to accommodate the placement of labels on the back side. Since there are six beverage alcohol bottle manufacturers of which we are aware, our company will have to begin placing orders soon. We typically keep an inventory of empty bottles approximately 3-4 months ahead of when they are to be filled.

7. In many cases it will be impossible to use existing inventories of labels and bottles, which will be unusable under the new rule, before the February 8, 1984 effective date of the new rule.

8. We estimate the cost of redesigning our brand labels to be $100,000 +. The cost of obtaining label approvals or complying with BATF rules regarding label approval will cost approximately $5,000.00. If a back label is required, change parts for our three plants will cost approximately $650,000 - $750,000. We estimate that the additional labor costs to be approximately $120,000. The initial inventory of new labels in the first year of the rule will cost approximately $800,000 to $1,000,000.

9. The costs of initiating administrative and production changes will be incurred immediately. For example, the planning for and construction of an additional station on the bottling line to apply additional labels will have to begin.

The process will have to be developed by which the correct labels, (particularly separate strip labels) will be retrieved from the inventory of labels to provide the information about the corresponding product.

10. Distilled spirits bottled outside the United States have additional time-delay problems. Implementation must begin at once because of the long lead time in preparing goods for export and shipping them.

I declare under penalty of perjury that the foregoing is true and correct to the best of my personal knowledge.

Dated: ______________________, 1983.

____

DECLARATION OF JOHN E. HEILMANN

I, JOHN E. HEILMANN, declare and state as follows:

1. I am and, since May 1, 1975, have been the President of Somerset Importers, Ltd., which is in the business of importing and distilling spirits and importing and producing wine.

2. I have reviewed the rule issued on June 13, 1980 by the Department of Treasury (T.D. ATF-66) which requires ingredient labeling or address listing for obtaining ingredients and which will become effective February 8, 1984. In order to comply with this date, my company must take action immediately, resulting in great expense and hurried production changes.

3. In order to meet the February 8, 1984 date, immediate and furious action is required. The design, production and inventorying of labels for approximately six sizes of approximately forty (40) brands of spirits and approximately two hundred (200) types of wines is, by itself, an enormous task. Added to this, however, will be the necessity in a number of cases of redesigning the labels and/or the bottles in order to accomodate the modified label. This would involve the art department, the marketing department and the production department of importers, distillers, and foreign suppliers. In addition, all advertising would have to be changed due to the "new look" of the labels and bottles, thus creating additional unanticipated expense which would drastically alter marketing budget plans.

4. After the labels have been designed and approved by the various departments within the company, and in many instances by the foreign suppliers, they must then be submitted to the Bureau of Alcohol, Tobacco and Firearms ("BATF") for approval. The BATF will be inundated with thousands of Form 1649, Form 1649 Supplemental or Form 1648 applications for new label approvals, and therefore extensive delays in obtaining said approvals will occur. Without the approvals, the labels cannot be printed.

5. In addition to federal label approvals, many states also require the filing of labels for state label approval. This cannot occur until after federal approval has been received. In addition to the state label filing requirement, some states also require the payment of a substantial fee for each and every label filed. This would again incur significant economic costs to the company and add a second time delay before labels could be printed.

6. After approval has been received by both the BATF and the state agencies, sufficient labels must be printed. A severe label supply problem will arise because of the limited number of companies which print wine and spirits labels and the overwhelming simultaneous demand for labels. We are aware of approximately ten major printing facilities from which we could obtain the labels. It will be impossible for such a small number of printers to accomodate industry-wide orders for new labels unless submitted forthwith.

7. Many bottles will have to be redesigned as the present bottles will not accomodate enlarged labels. This will entail the fabrication of new bottle molds. In some cases, new back labels will have to be produced which may also affect the bottle shape. We are only aware of a few alcoholic beverage bottle manufacturers capable of supplying our needs. Because of this fact our company would have to place orders in the very near future. Under ordinary circumstances, we keep approximately three months ahead of when the bottles are to be filled.

8. In many cases, it will be impossible to deplete existing inventories of labels and bottles prior to the February 8, 1984 cut-off date. For example, we have no less than a one-year inventory on Weller 107, Old Fitzgerald 1849, John Begg Scotch, Appleton Rums and a two-year inventory on Pimm's Number 1 Cup (due to economics, it is often necessary to purchase large numbers of labels at one time).

9. Many of our brands, especially those which are imported, have labels and bottles designed for worldwide use. Therefore, any necessary changes would involve burdens not only to my company, but also to each of my company's foreign suppliers. This could affect their worldwide marketing system.

Also, distilled spirits bottled outside the United States have additional time-delay problems.

10. We estimate the cost of redesigning our brand labels to be approximately $150,000. The cost of obtaining label approvals or complying with BATF and state rules regarding label approval will cost approximately $30,000 (thirty thousand dollars).

11. Costs of initiating administrative and production changes will be incurred. For example, extra manpower will be necessary in order to assist in filing the enormous amount of labels where required. Also, additional personnel and space on the bottling line will be necessary should new back labels be required.

I declare under penalty of perjury that the foregoing is true and correct to the best of my personal knowledge.

Dated: June 6, 1983, 1983

John E. Heilmann

DECLARATION OF WILLIAM E. WUNDER

I, William E. Wunder, declare and state as follows:

1. I am and, since April, 1975, have been Vice President-Production and Engineering of Joseph E. Seagram & Sons, Inc. ("Seagram"). Seagram is in the business of producing, importing and marketing distilled spirits and wines.

2. I have reviewed the Department of Treasury's Rule T.D. ATF-66 dated June 13, 1980 which requires ingre-

dient labeling or address listing for obtaining ingredient information. The Department of the Treasury has now set February 8, 1984 as the date on which the ingredient labeling rule becomes mandatory. In order to be in compliance with the rule by that date, implementation by my company will have to begin at once. This will cause us to incur economic costs and make production changes which are certain, great and immediate.

3. A rule that all spirits bottled after February 8, 1984 carry the new label information will require immediate action. The design, production and inventorying of large numbers of labels for 275 bottle sizes for domestic brands and in some cases the designing of new bottles to accomodate the altered size or number of labels will involve Seagram's art department, advertising department, marketing department, legal department, and production department. Use of the optional address statement also would create considerable label design problems, since the regulations regarding this option are more limiting. For example, the optional address statement must be in type size twice as large as ingredient information and must be on the front of the bottle. Sections 5.33 (b)(4) & (5) , 5.39a (a)(2)(ii). Since doubling the size of the type increases both the width and height of each letter, considerable label space will be needed, thus necessitating a redesigned label.

4. After new labels are designed and approved by Seagram, they will have to be submitted to the Bureau of Alcohol, Tobacco and Firearms ("BATF") in accordance with Federal law for approval. Since the BATF will be inundated with thousands of label approval applications, as required by 27 CFR Section 5.39a, there will be very lengthy delays in obtaining the approval of our new labels. Moreover, we, like most producers, have many technical questions concerning the appropriate language which will be required in the ingredient listing. BATF will be required to resolve

these questions before we can even be in a position to create new proposed labels. These questions include such matters as: what is an additive? how will enzymes be labeled? can sugar refer to all sweeteners or must the specific type be listed? must each natural/artificial flavor be listed separately? We expect our deliberations with the BATF over these and similar issues will take at least several months. We will not be able to order our full complement of initial run labels until our new labels have received BATF approval. Thus, the design and preparation of new labels will have to begin at once to even have a chance of meeting a February 1984 mandatory compliance.

5. Following approval by the BATF, we will have to have sufficient labels printed. Unless orders for labels are placed forthwith, a severe label supply problem will arise because of the limited number of companies which print wine and spirits labels. We are aware of only ten printing companies capable of meeting our specifications from which we could obtain labels. We do not believe they would be able to accomodate industry-wide orders placed simultaneously. Since the regulation will apply to each product of the entire beverage alcohol industry, orders for printing will have to be submitted in the very near future.

6. Many of our present bottle designs will not accomodate the labels which would have to be enlarged to contain the information required by the rule. New bottles will have to be designed and new bottle molds fabricated to replace those bottles which have a limited smooth surface to which any new, larger, or additional labels would not adhere. In some cases back side labels will have to be produced and new bottles will have to be designed and molds made to accomodate the placement of labels on the

back side. Seagram anticipates that it would expend $1,440,000 for new glass molds required to accomodate back labels. If the 100 ml and the 375 ml become approved sizes this summer, this amount would increase to $1,858,000. Seagram is aware of twelve beverage alcohol bottle manufacturers (of which only nine are capable of complying with our specifications) and thus our company will have to begin placing orders soon. Leadtime required for new glassware molds is 6 months. Our vendors keep an inventory of empty bottles approximately one to four months ahead of when they are to be filled, except for slow moving items. Glassware inventories for such "slow movers" may be manufactured as infrequently as once or twice per year.

7. In many cases it will be impossible to use existing inventories of labels and bottles, which will be unusable under the new rule, before the February 8,1984 effective date of the new rule. For example, glassware obsolescence for three items (Kessler 200 ml, Wolfschmidt 200 ml, and Benchmark liters) will amount to $60,835. Label obsolescence, for 31 different items, handled by four marketing companies, would amount to $60,535.

8. We estimate the cost of redesigning our brand labels to be $299,000, and if the 100 ml and 375 ml become approved sizes this summer, this amount will increase to $308,000. The cost of obtaining label approvals or complying with BATF rules regarding label approval will cost approximately $6,000. Modification of existing bottling line equipment or the addition of new equipment will cost approximately $500,000. The initial inventory of new labels in the first year of the rule will cost approximately $1,385,000. If the 100 ml and 375 ml become approved sizes this summer, this amount would increase to $2,230,000.

9. Distilled spirits bottled outside the

United States have additional time-delay problems. Implementation must begin at once because of the long lead time in preparing goods for export and shipping them. In a few countries a full 12 months leadtime is necessary.

I declare under penalty of perjury that the foregoing is true and correct to the best of my personal knowledge.

Dated: May 20, 1983

William E. Wunder
Vice President
Production and Engineering
Joseph E. Seagram & Sons, Inc.

DECLARATION OF AUSTIN, NICHOLS & CO., INC.

I, Thomas R. McCarthy, declare and state as follows:

1. I am and, since January, 1960, have been the Vice President of Austin, Nichols & Co., Inc.. Austin, Nichols & Company, Inc. is in the business of bottling liquor.

2. I have reviewed the rule issued by the Department of the Treasury on June 13, 1980 as T.D. ATF-66, which requires ingredient labeling or address listing for obtaining ingredient information. The Department of the Treasury has now set February 8, 1984 as the date on which the ingredient labeling rule becomes mandatory. In order to be in compliance with the rule by that date, implementation by my company will have to begin at once. This will cause us to incur economic costs and make production changes which are certain, great, and immediate.

3. A rule that all spirits bottled after February 8, 1984 carry the new label information will require immediate action. The design, production and inventorying of large numbers of labels for approximately 120 different

items representing differenct sizes and brands. New bottles would be required to accomodate the altered size or number of labels which will also involve the art department, advertising department, marketing department, and production department of spirits bottlers and importers. Use of the optional address statement also would create considerable label design problems, since the regulations regarding this option are more limiting. This results from the requirement that the optional address statement must be in type size twice as large as ingredient information and must be on the front of the bottle.
Sections 5.33 (b) (4) & (5), 5.39a (a) (2) (ii). Since doubling the size of the type increases both the width and height of each letter, considerable label space might be needed, thus necessitating a redesigned label. Many of our packages only have one single front label, some with front label with top and bottom strip and finally those with back labels as well. Any change, no matter how small, adds considerable cost.

4. After labels are designed and approved by the company, they will have to be submitted to the Bureau of Alcohol, Tobacco and Firearms for approval. Since the Bureau of Alcohol, Tobacco and Firearms will be inundated with thousands of Form 1649 or Form 1649 Supplemental applications for approval of new labels, as required by Section 5.39a, there will be very lengthy delays in obtaining the approval of new labels. We will not be able to order our full complement of initial run labels until our new labels have received approval from the Bureau of Alcohol, Tobacco and Firearms. Thus, the design and preparation of new labels will have to begin at once to meet a February 1984 effective date.

There is a tremendous problem in most of the states of the U.S. because of the state requirements to file new registrations with additional fees for any change in the label that had previously been approved. This would definitely result in additional cost of many thousands of dollars and probable hiatus in sales until the new registrations are approved.

5. Following approval by the Bureau of Alcohol, Tobacco and Firearms, we will have to have sufficient labels printed. Unless orders for labels are placed forthwith, a severe label supply problem will arise because of the limited number of companies which print wine and spirit labels. We are aware of only 3 printing companies from which we could obtain labels. They would not be able to accomodate industry-wide orders placed simultaneously. Since the regulation will apply to each product of the entire beverage alcohol industry, orders for printing will have to be submitted at the earliest possible moment.

6. Many bottle designs will not accomodate labels which are enlarged in order to contain the information required by the rule. New bottles will have to be designed and new bottle molds fabricated to replace those bottles which have a limited smooth surface to which any new, larger, or additional labels would not adhere. In some cases back side labels will have to be produced and new bottles will have to be produced and new bottles will have to be designed and molds made to accomodate the placement of labels on the back side. Since, to our knowledge, there are only 4 beverage alcohol bottle manufacturers, our company will have to begin placing orders immediately. We typically keep an inventory of empty bottles approximately three months ahead of when they are to be filled.

7. In view of the fact that it is impossible to forecast the volume of use of the many different labels prior to February 8, 1984, it will be impossible to estimate

the tremendouse loss of the unsaleable inventory on such date.

8. We estimate the cost of redesigning our brand labels to be $100,000. The cost of obtaining label approvals or complying with BATF rules regarding label approval will cost approximately $10,000. Modification of existing bottling line equipment or the addition of new equipment will cost $110,000. The initial inventory of new labels in the first year of the rule will cost a minimum of $25,000.

9. The costs of initiating administrative and production changes will be incurred immediately. For example, the planning for and construction of an additional station on the bottling line to apply additional labels will have to begin. The process will have to be developed by which the correct labels: main labels, neck strips, bottom strips, back labels etc., (particularly separate strip labels) will be retrieved from the inventory of labels to provide the information about the corresponding product. The cost of record-keeping systems to monitor the inventory and use of all food additives and any other ingredients cannot be estimated but will certainly be in excess of $100,000 per year.

10. Distilled spirits bottled outside the United States have additional time-delay problems. Implementation must begin at once because of the long lead time in preparing goods for export and shipping them. Just to cite a few examples of delays in different countries our experience has shown a 9 month delay in Scotland and France and 1 year in Lebanon.

I declare under penalty of perjury that the foregoing is true and correct to the best of my personal knowledge.

Dated: ________________, 1983

____
Executive Vice President

DECLARATION OF NELLO TREVISAN

I, NELLO TREVISAN, declare and state as follows:

1. I was a Heublein employee from 1971 through 1976 and returned in 1981. Soon thereafter I became the Vice President of Manufacturing at Heublein Spirits, an operating unit of Heublein, Inc. ("Heublein"). The predecessor company of Heublein ("Old Heublein") was incorporated in 1915 under the laws of the State of Connecticut as the successor to a family business founded in the 1870's. Old Heublein was merged into Reynolds Tobacco Company, a subsidiary of R. J. Reynolds Industries, Inc., in October 1982 and its assets and liabilities were immediately thereupon transferred to HBL, Inc., a subsidiary of Reynolds Tobacco, which subsequently changed its name to Heublein, Inc. Heublein Spirits is engaged worldwide in the production and distribution of distilled spirits.

2. I have been in the alcoholic beverage industry since 1971. I am familiar with earlier efforts on the part of the Bureau of Alcohol, Tobacco and Firearms and the Food and Drug Administration to mandate ingredient labeling for beverage alcohol.

3. I have read the order of the U. S. District Court for the District of Columbia in Center for Science in the Public Interest, et al., v. Department of the Treasury, et al., Civil Action No. 82-610. I have reviewed also the final rule issued by the Department of the Treasury on June 13, 1980 and which appears at 45 Fed. Reg. 40538 ("Ingredient Labeling Rule"). The Court's order sets February 8, 1984 as the final date by which the Department of the Treasury may make the ingredient labeling rule mandatory. In order to be in compliance with the rule by that date, implementation by Heublein will have to begin immediately. Further it requires Heublein to incur increased costs and make numerous production changes which are great and immediate.

4. A rule that all spirits bottled after February 9, 1984 carry the new label information, will require immediate action by Heublein. The design, production, change, and inventorying of at least 700 labels for many bottle sizes and brands and in some cases the designing of new bottles will involve the art department, advertising department, marketing department, and production department of Heublein.

5. After labels are designed and approved by Heublein, they will have to be submitted to the Bureau of Alcohol, Tobacco and Firearms and various state agencies for approval. Since the Bureau of Alcohol, Tobacco and Firearms and state agencies will be inundated with thousands of applications for approval of new labels with ingredient labeling information, it is likely that there will be very lengthy delays in obtaining the approval of new labels. Heublein will not be able to order their full component of initial run labels until they have received approval from the Bureau of Alcohol, Tobacco and Firearms and state agencies. Thus, the design and preparation of new labels will have to begin at once to meet a February 1984 effective date.

6. Following approval by the Bureau of Alcohol, Tobacco and Firearms, Heublein will have to have labels printed. Unless orders for labels are placed at an early date, a severe label problem will arise because only six companies are capable of printing wine and spirits labels. They would not be able to accommodate industry-wide orders placed simultaneously. Since the regulation will apply to each product of the entire beverage alcohol industry, orders for printing will have to be submitted in the very near future.

7. Certain valuable bottle designs will not accommodate labels which are enlarged in order to contain the information required by the rule. I refer particularly to Smirnoff vodka and our entire line of Club cocktails. Hence, new bottles will have to be designed for these products and new bottle molds fabricated to replace those bottles which have a limited flat surface to which the new larger labels would not adhere, in order to accommodate larger size labels. In the absence of the ingredient labeling requirement, Heublein would have continued its program of removing back labels. Heublein has recently completed the removal of back labels on bottles representing 75% of total shipments. Now in some cases back side labels will have to be produced

and new bottles will have to be designed and molds made to accommodate the placement of labels on the back side. Since there are only a small number of bottle manufacturers in the United States, the conversion of the entire industry would have to begin at once. Indeed, Heublein typically keeps an inventory of empty bottles approximately three to twelve months, depending on item, ahead of when they are to be filled.

8. In many cases it will be impossible to use existing inventories of labels and bottles, which will be unusable under the new rule, before the February 1984 deadline. This will result in a financial loss of $200,000 for Heublein.

9. Heublein has prepared estimates of the cost of implementation of the ingredient labeling rule. The start-up costs computed for Heublein are as follows. Labels for 700 brands and/or sizes would have to be redesigned at a estimated cost of $1.5 million. Testing for correct ingredient determination would cost $50,000. All of Heublein's 30 bottling lines in operation would require either modification or new equipment at an estimated cost of $470,000 and additional operators would have to be hired at a cost of $270,000. New bottle molds for containers whose present design would not permit an additional label would cost $750,000. Additional administrative costs would be $900,000. Obtaining State and Federal Government approvals for label changes would cost $195,000. Initial inventories of new labels would cost an estimated $1.6 million. The total estimated initial start-up cost would be $5.74 million for Heublein. These expenses will begin immediately, because of the need to begin implementation of ingredient labeling at once to meet a February 1984 deadline.

10. The costs of initiating administrative and production changes will be incurred immediately. For example, the planning for and construction of an additional station on the bottling line to add labels will have to begin. Production and quality control personnel will have to begin planning the ingredient testing process so that where common ingredients are used interchangeably ingredient determination can be done. The process by which the correct labels will be retrieved from the inventory of labels in order to be placed on the product containing the corresponding ingredients will have to be developed.

11. Alcoholic beverages bottled outside the United States which are imported by Heublein will suffer from additional time delay problems unless implementation begins at once because of the long lead time in shipping bottled case goods from abroad. The United States would be the only country that would have such labeling. The strain placed on Heublein's relations with other countries would be entirely unnecessary and absent a genuine need for such ingredient labeling and the impositon on this requirement by the United States will be viewed by alcoholic beverage exporting countries as a hindrance to free trade. Also, Heublein would be required to have a dual inventory of labels. The United States labels would be different than those required to be used elsewhere in the world. It is possible that due to the additional cost, as well as foreign opposition, that those foreign countries may retaliate by placing additional requirements and/or restrictions on goods exported from the United States. The ultimate effect will be higher consumer prices and fewer consumer choices in the market.

12. There are other factors which will create additional burdens if ingredient labeling is mandated. I refer particularly to the depressed alcoholic beverage market and Heublein's recent closing of its manufacturing plant in Paducah, Kentucky. Taken together with the additional burden from ingredient labeling may cause further consumer dissatisfaction with our alcoholic beverage products and loss of revenue and jobs.

13. To conclude, the costs will need to be incurred immediately in the development of new labels or the amendment of existing labels. In many cases the development of new bottles will be necessary. The commitment to the production of the new labels and new bottles for initial run cannot be made until the lengthly process of review and approval is completed by the Bureau of Alcohol, Tobacco and Firearms and state agencies. Then because of the

small number of label printers and bottle producers and because the entire industry will be needing complete supplies all at the same time, Heublein will have to begin expending the human resources and money to comply with the February 1984 deadline immediately.

I declare under penalty or perjury that the foregoing is true and correct to the best of my personal knowledge.

Dated: 6/2, 1983

Nello Trevisan

DECLARATION OF STEVEN NACLERIO

I, STEVEN NACLERIO, declare and state as follows:

1. I am and, since May 1977, have been the Assistant General Counsel of Bacardi Imports, Inc., the importer and national distributor of BACARDI rum and other brands of distilled spirits and fine wines.

2. I am familiar with the rule issued by the Department of the Treasury on June 13, 1980 as T.D. ATF-66, which requires ingredient labeling or address listing for obtaining ingredient information. The Department of the Treasury has now set February 8, 1984 as the date on which the ingredient labeling rule will be mandatory. In order to be in compliance with the rule by that date implementation by my company and all of its beverage alcohol suppliers will have to begin at once. This will cause us and our suppliers to incur large costs and make production changes which may ultimately prove unnecessary.

3. A rule that all spirits bottled after February 8, 1984 carry the new label information requires immediate action by ourselves as well as our suppliers. Even for a small company such as Bacardi Imports, the design

and production of large quantities of labels for approximately 500 different brands and bottle sizes will involve our advertising department, marketing department and sales department as well as those of our various suppliers and our advertising agency. Adoption of the optional address statement also creates considerable label design problems since the regulations regarding this option are limiting. For example, the optional address statement must be in type size twice as large as ingredient information and must be on the front of the bottle. Since doubling the size of the type increases both the width and height of each letter, considerable label space is needed. This necessitates redesigned labels by each brand owner. The proportions of the artwork on our Nassau Royale liqueur front label, for example, should be changed to accommodate the optional statement and to retain a label which is visually pleasing.

4. After all the various labels are designed and approved by the responsible parties, they will have to be printed and then submitted to the Bureau of Alcohol, Tobacco and Firearms for approval. This will not be an easy process since the regulations are not specific and many additional questions must be answered by the Bureau before a final list for each product can be formulated. Since the Bureau will be flooded with large numbers of applications for approval of new labels, there should be delays of considerable length in obtaining the approval of new labels. Neither we nor our suppliers will be able to order a sufficient complement of initial run labels until the new labels have received approval from the Bureau. Thus, the design and preparation of new labels will have to begin now to meet a February 1984 effective date.

5. Following approval by the Bureau of Alcohol, Tobacco and Firearms, each one of our suppliers will have to have sufficient labels printed. Unless orders for labels are placed forthwith, a severe label supply problem will arise because of the limited number of companies which print these labels. In the past our primary supplier has used only one printing company for our labels. This company would not be able to accommodate simultaneous industry-wide orders. Since the regulations will apply to each product of the entire beverage alcohol industry, orders for printing will have to be submitted in the very near future.

6. In many cases it will not be possible to exhaust existing inventories of labels before the regulation's effective date. This is particularly true of some of our slower moving liqueurs and wines for which substantial quantities of labels must be ordered at one time to minimize printing costs.

7. Our suppliers estimate the cost of the artwork alone for redesigning our brand labels to be approximately $20,000. Printing costs for new embossing plates are likely to exceed $50,000 for all brands involved. The cost of obtaining label approvals or complying with BATF rules regarding label approval will cost approximately $10,000 in general and administrative expenses providing all current ambiguities in the regulations can be expeditiously resolved.

8. Distilled spirits and wines bottled outside the United States have additional time-delay problems. Implementation must begin now because of the long lead time

in preparing goods for export and shipping them. In addition, many small wine producers in Europe will have considerable difficulty in determining the proper list of ingredients to utilize and in modifying and applying labels which are not consistent with their prior practice.

I declare under penalty of perjury that the foregoing is true and correct to the best of my personal knowledge.

Dated: June 3, 1983

Steven Naclerio

DECLARATION OF BLACK PRINCE DISTILLERY, INC.

I, Robert Guttag, declare and state as follows:

This is in reference to the rule issued by the Department of the Treasury, T.D. ATF-66, relating to ingredient labeling. We are primarily a contract bottler of distilled spirits. We bottle for approximately twenty independent distributors and retailers.

In most cases, we supply labels for our customers, of their design. In many cases, because of the size of orders, we have as much as a year to two years' supply of their labels on hand. In certain instances, through improper sales projections or poor sales performance, these customers' labels are even in excess of two years' supply.

Our overall inventory of labels was valued at $380,000 on March 31, 1983. Obviously, if we were to be required to abide by the February 8, 1984 date on which ingredient labeling becomes mandatory, this would work a tremendous hardship on all of us. The loss would not be a complete loss, when neck wraps, and probably most front labels, could be salvaged.

The problem of printing new labels would be complicated, due to the many decisions from our different customers, as to how they would handle the mandatory information which would be required of them. Many of these customers import their own products from many overseas suppliers and will have to obtain for us the details required by this new ruling.

In order to maintain inventory of finished goods, our inventory will vary from the six-week supply, to as much as one year's supply of product. This may be explained by the fact that we receive imports in tank containers. It is essential that we empty and bottle the contents of the shipping container as rapidly as possible. We must do this in order to free our receiving tank so that it is available to receive other shipments.

It is also necessary that we do this in order to bottle sufficient quantities of the product to have economical runs; and also by our bottling the product immediately it prevents loss of product through evaporation.

We present the above data with the hope that there can be a delay in putting this ruling into effect.

U.S. Customs Service

Mr. Tobias. I would like to turn now to the U.S. Customs Service.

Mr. Tobias. Again, OMB and this administration, this President has recommended every year in the last 6 years that the U.S. Customs Service be cut. This is true in spite of the fact that commercial fraud now stands at $40 billion annually, uncollected revenue from the commercial fraud at $3 billion. We loose 500,000 jobs annually from the fact that imported goods—illegal goods are imported and, of course, the country is awash with drugs.

There is a great deal of dispute among the various agencies about how much is actually coming into the country, but anybody who reads anything knows that the prices are down, cocaine, and marijuana, heroin and so when the prices go down, that means there is more drugs available on the street.

There is an estimate of only 4.5 percent of the heroin being seized, 18 percent of the cocaine and 4 percent of the marijuana. I think those numbers are very high.

But, in spite of these facts, the President proposed in the 1987 budget for the U.S. Customs Service to decrease the Customs Service by 770 positions, 400 inspectors and 150 import specialists. It is terribly wrong headed—terribly wrong headed.

We recommend to this committee that 1,547 positions be restored so it is at the 1986 continuing resolution level and add another 600 additional positions.

Adding these positions wouldn't cost the Government money, it would yield $735 million in additional revenue. It's ironic that I come to testify before this committee asking it to expend money when every dollar expended yields some $20 in revenue.

This is not a situation where people are asking for handouts. This is a situation where people are asking for money so that we can provide more revenue. I think it very short sighted for the Congress to be focusing only on expenses and not on additional revenue.

So we urge this committee to fund the Internal Revenue Service by hiring more people, fund the U.S. Customs Service by hiring more people and we believe that we will return that 20 to 1 investment. Thank you very much, Mr. Chairman.

Senator Abdnor. Thank you Mr. Tobias. For the record, once again, let me say we're trying to do that very thing and I guess no one is more aware of this than Senator DeConcini. He couldn't be here today.

We do have big problems, but we're going to do everything possible to correct this because we believe there is a need for fighting drugs as much as any committee on Capitol Hill. It's destroying America and we all know it, so we'll certainly see what we can do with the restrictions we have on it.

Mr. Tobias, Senator Mattingly has a couple of questions on the Customs Service that he would like to have you respond to in writing.

Mr. Tobias. I would be pleased to do that.

PREPARED STATEMENT

Senator ABDNOR. Your complete statement will be included in the record, without objection. Thank you, Mr. Tobias.

[The statement follows:]

SUMMARY STATEMENT OF ROBERT M. TOBIAS

I am Robert M. Tobias, National President of the National Treasury Employees Union. Our union is the exclusive representative of over 120,000 Federal workers, including virtually all employees of the Internal Revenue Service and U.S. Customs Service. I am accompanied today by Patrick Smith, NTEU Director of Legislation, and Paul Suplizio, Legislative Consultant.

The most serious problem facing the nation's tax system today is the need to stem the fall in voluntary compliance. IRS projects voluntary compliance to fall from 81.6 percent this year to 79 percent by 1990. This amount may not appear large, but it is enormous when you consider that for each 1 percent decline, $7 billion is lost to the Treasury. Viewed in historical perspective, compliance was around 90 percent in the sixties, fell to 84 percent by 1975, and has been declining steadily since then. As a result, the tax gap -- the difference between taxes legally owed and those voluntarily paid -- stands at $100 billion today and will rise to $159 billion by 1990.

There has been a hardening of cynicism toward their tax obligation on the part of many of our citizens. In the words of the General Accounting Office, there is a trend toward contempt and abuse of the system that undermines the compliance of others. An opinion survey conducted for IRS by Yankelovich, Skelly and White found that 20 percent of the sample admitted to cheating on their taxes, and a third believe that it is all right to cheat because others do so. The belief that others cheat and get away with it is the basic reason for non-compliance.

The failure to confront this problem is a national failure -- a failure for which the present Administration bears a large burden of responsibility. Not until after it had plunged the tax system to its lowest performance in history, not until after the humiliating events of the last filing season, not until millions of irate citizens raised their voices in indignation, did the Administration come forward with a sensible budget for IRS in the current fiscal year.

We believe there is still time to restore the system's health but, quite frankly, Mr. Chairman, we have been saying this for six years and time is slipping away.

We must place high on the national agenda the goal of halting the decline in voluntary compliance. And we must provide IRS with the resources necessary to achieve this goal.

We believe that the Federal government should immediately announce a comprehensive program to strengthen enforcement of the tax code and bring non-compliant taxpayers onto the tax rolls once more. Essential components of the program we envision are:

- a one-time tax penalty amnesty whereby taxpayers who owe money may avoid civil and criminal penalties by paying what they owe plus interest within a specified amnesty period;
- providing IRS with additional enforcement resources, particularly in Examination, Collection, and support staff, to increase enforcement actions against non-compliant taxpayers before and after the amnesty period;
- change the tax code to give IRS better enforcement tools and to increase penalties for non-compliance when the amnesty is over.

We believe stronger enforcement can work in tandem with a one-time amnesty to halt the fall in compliance. Both would result in large additional revenues accruing to the Treasury.

NTEU has computed that just keeping the compliance rate from falling will yield $55 billion over 5 years (Table 12). An additional $20 billion would result from enforcement actions. We should also include part of the $100 billion annually that is now going uncollected, but would be paid by taxpayers as a result of the amnesty.

It is unrealistic to expect that the entire $100 billion would come in if amnesty were declared, as that would imply 100 percent compliance. We estimate that $40-$50 billion could be recovered under an amnesty program, as this figure is consistent with 90 percent compliance.

Adding the sums I have mentioned--$55 billion from improved compliance, $20 billion from stronger enforcement, and $40-$50 billion from amnesty, yields a total of $115-$125 billion in estimated additional revenue from the program I have outlined. This is the gain if we just keep compliance from falling. If we can raise compliance generally by five percentage points, from 81.6 to 86.6 percent, an additional $35 billion a year would result.

We believe the fact that we have a voluntary compliance system in this country makes amnesty feasible. IRS now has detailed records on all citizens' incomes and filing status, and can identify those who are non-compliant. However, we must face the fact that IRS will never have sufficient resources to deal with all the non-compliant population. By offering each taxpayer a chance to pay up without penalty, we believe a large number can be brought back into voluntary compliance with the law.

Strengthening tax enforcement by examining more returns, collecting more past-due accounts, and putting abusive tax shelters out of business should not be viewed as an imposition on our citizens. I know that many people -- perhaps including some in this room -- believe that IRS should not be "unduly intrusive" into their lives. That phildsophy has led to six straight years of declining audit coverage and rampant cheating. In the 1960's, audit coverage was more than 5% and yet our freedoms did not suffer. Effective tax enforcement sends the message that those who do not pay their fair share will be caught and required to pay. It is a bulwark of voluntary compliance.

We welcome the Administration's supplemental request for $340 million for FY 1986. After deducting the Gramm-Rudman cut of $157 million, there will be a net addition to IRS resources of $183 million and 7,000 average positions. These resources are urgently required to assure efficient processing of 6 million additional returns and refunds, to strengthen taxpayer services, and to commence hiring 2,500 additional Revenue Agents and Tax Auditors that are sorely needed and long overdue.

Unfortunately, OMB has a fleeting attention span, because its FY 1987 request for IRS is a reversion to the discredited policies that led to the 1985 fiasco. The evidence on this point is clear. In this budget, OMB authorizes four important program initiatives -- a revenue initiative to strengthen Examinations, a Tax Shelter Initiative to clear up the backlog in Appeals, a Document Matching Initiative to improve collections from underreporters, and an ADP Initiative to strengthen returns processing. These initiatives are essential and long overdue. To implement them, and allow for processing additional returns, 4,300 average positions are required.

Yet the budget provides a net increase of only 1,360 average positions. The remaining resources are to be obtained from within IRS, by reducing Returns Processing. Obviously, the folly of ratcheting the Returns Processing staff level down again escapes OMB. We are told that workload backlogs will be cleaned up this year, so the positions will not be required. But there will be 3.5 million additional returns and supplemental documents to be processed in FY 1987. We are strongly of the opinion that staff in Returns Processing is still inadequate and should not be reduced. Staff completing one-time assignments should be directed to other work. GAO, in earlier reports, has criticized the inefficient practice of ratcheting staff levels up and down in the face of increasing workload. To revert to a policy of cannibalizing some programs to pay for others is sheer folly.

There are two other glaring deficiencies in this budget. First, the number of taxpayers assisted through toll-free telephone, walk-in, and correspondence is projected to fall from 50 to 45 million. There is no justification for such a decrease, particularly if tax reform should be enacted this year.

Second, the Collection staff is to be cut 1,500 positions and the number of Revenue Officers working past-due accounts is to be held constant for the fourth year in a row, despite mounting caseloads. In view of the increasing number of delinquent accounts, the total of more than $30 billion owed in such accounts, and the return of $20 for each dollar spent in Collection, we believe there is no justification for ratcheting down the staff level.

To sum up the IRS budget for FY 1987, NTEU recommends restoration of 2,700 positions to maintain an adequate Returns Processing staff, addition of 500 positions to Taxpayer Service to assure that 50 million taxpayers will again be assisted next year, and restoration of 1,500 positions scheduled to be cut from Collection so that 316,000 more taxpayer delinquent accounts can be worked. These additions would cost $131 million, but would bring in $570 million in additional revenue annually.

U.S. Customs Service

I'd like to turn now to the U.S. Customs Service. This year Congress will conduct a major review of the nation's trade laws. Enforcement should be an important part of that review. Our trade laws are not self-enforcing; they must be policed in order to be effective.

Under the Multifiber Arrangement, Customs keeps track of over 600 different countries. Voluntary Restraint Agreements are in effect with more than 20 countries under the President's Steel Program. Under the Generalized System of Preferences, more than 3,000 products from 103 developing countries are eligible to enter the U.S. at lower rates of duty. The Caribbean Basin Initiative authorizes duty-free treatment for a variety of products from the 21 nations and territories of that region. Anti-dumping and countervailing duty orders are on the upswing; these must be enforced by Customs. Virtually all of the statistical data on which trade policy is based is obtained by Customs.

Despite these growing enforcement responsibilities, OMB has recommended severe cuts in U.S. Customs Service budgets for every one of the last six years. Without any doubt, the

Administration bears the chief responsibility for the rampant commercial fraud that now exists.

Our estimate is that commercial fraud now amounts to $40 billion annually, including $2 billion in counterfeit goods, and more than $25 billion in unreported products that enter in shipments that are not inspected. Today, 98 percent of containerized shipments enter the country without inspection. It is not surprising that our markets are awash with illegal imports that not only cost American jobs but endanger the health and safety of our people.

Based on research conducted by the Commerce Department, NTEU has been able to estimate the number of jobs lost from illegal imports in 1984. We found that 144,000 jobs were lost in textiles and apparel, 76,000 in electronic products, 42,000 in motor vehicles, 32,000 in iron and steel, and 50,000 in leather goods industries due to illegal imports alone. All told, nearly a half million jobs have been taken from American workers by fraudulent importers and trading companies. The Administration bears the entire responsibility for this disgraceful situation.

NTEU supports the FY 1986 Urgent Supplemental as approved by the House Appropriations Committee, which restores the Gramm-Rudman cut of $35 million and 777 positions, and will result in additional budget receipts of $1.3 billion during FY 1986-1990.

The President's budget request for FY 1987 would result in a reduction in force of 770 Customs officers, including 400 Inspectors and 150 Import Specialists, despite the fact that commercial fraud and narcotics traffic are at an all-time high. We believe this budget should be rejected.

For FY 1987, NTEU recommends that $56 million and 1,547 positions be added to the Administration's request to maintain the level of the FY 1986 C.R., and that an additional $21 million and 600 positions be provided to adequately enforce the nation's drug and trade laws. Of the 600 new positions, 134 are required to collect billions of dollars in new export and import fees earmarked for the harbor maintenance trust fund established by the port and waterways bills (H.R.6 and S. 1567) that have passed both bodies. The remaining positions would be applied to commercial cargo enforcement, where Customs is seriously understaffed, and would yield additional revenue of $735 million during FY 1987-1989.

Lastly, Customs continues toward centralization without adequate assessment of the consequences. It continues to plan to consolidate ports, districts, and duty assessment locations despite repeated injunctions from Congress not to do so. By not replacing import specialists lost through attrition, hiring replacements only in certain favored ports, shifting the entry workload to those ports, and retaining a single import specialist or entry clerk at less-favored ports to placate local business communities, Customs continues to move toward centralization. We urge this subcommittee to ban the use of funds for any administrative expenses associated with planning or executing such activities. Congress should reaffirm its clear intention that Customs provide a full staff complement at all existing ports, including increasing staff as required to process growing workload.

Mr. Chairman, we appreciate the opportunity to appear before you today on behalf of the thousands of employees who collect the revenue of the Federal government and enforce the trade laws of our country. I would be happy to answer any questions.

STATEMENT OF ROBERT M. TOBIAS

I am Robert M. Tobias, National President of the National Treasury Employees Union. NTEU is the exclusive reprsentative of over 120,000 Federal workers, including virtually all employees of the U.S. Customs Service worldwide. With me are Patrick Smith, NTEU Director of Legislation, and Paul Suplizio, Legislative Consultant.

On behalf of the thousands of dedicated men and women who enforce the trade laws of our country and collect essential revenue for the Federal government, I am pleased to appear before you to testify on the FY 1987 appropriation for the U.S. Customs Service.

Customs Funding Should Be Increased

In the FY 1986 Continuing Resolution, Congress approved 623 new positions for Customs and directed that staffing be maintained at the 14,041 level. The 623 positions were wiped out by Gramm-Rudman cuts of $31 million and 777 positions for salaries and expenses, and $4 million for the narcotics air interdiction program. NTEU supports the FY 1986 Urgent Supplemental Appropriation as approved by the House Appropriations Committee, which restores the Gramm-Rudman cut of $35 million. This will result in additional budget receipts from improved compliance with the Customs laws of $1.3 billion during FY 1986-1990, according to CBO data presented to the Budget Committee last year.

The President's budget request would result in a reduction in force (RIF) of 770 Customs officers in FY 1987, including 400 Inspectors and Import Specialists, despite the fact that commercial fraud and narcotics traffic are at all-time high levels, and that Customs is a revenue-producing agency which returns $20 for every dollar appropriated. Counting the Gramm-Rudman cut, the Administration's request is $56 million and 1,547 positions below the level that Congress deemed essential in the FY 1986 Continuing Resolution.

For FY 1987, NTEU recommends that $56 million and 1,547 positions be added to the Administration's request to maintain the level of the FY 1986 Continuing Resolution, and that an additional $21 million and 600 positions be provided to adequately enforce the nation's drug and trade laws. Of the 600 new positions, 134 are required to collect billions of dollars in new export and import fees earmarked for the harbor maintenance trust fund established by the Port And Waterways bills (H.R.6 and S.1567) that have passed both bodies. The remaining positions would be applied to commercial cargo enforcement; where Customs is woefully understaffed, and would yield additional revenue of $735 million during FY 1987-1989. **NTEU's budget recommendations are summarized in Table 1.**

Gramm-Rudman entails Large Costs

The adverse impact of across-the-board budget cuts on revenue-producing agencies such as Customs is illustrated by the Gramm-Rudman cut of $35 million imposed for FY 1986. Last year, the Congressional Budget Office estimated that 800 additional positions applied to improve compliance in entry processing, duty collection, and cargo inspection would yield additional budget receipts of $1.315 billion over three years. Since this year's Gramm-Rudman cut is approximately the same size (777 positions) as the CBO estimate, a revenue loss of $1.3 billion will be incurred in FY 1986-1988 as a direct result of this $35 million cut.

It is not anticipated that Customs would have no further requirement for these positions after FY 1988. Rather, since workload is increasing, they would undoubtedly continue to be required through 1991 and beyond. According to CBO, these 800 positions would continue to generate revenue at the rate of $615 million annually. The total revenue forgeone during the six-year time span of Gramm-Rudman, FY 1986-1991, would thus be $3 billion as a result of a single $35 million cut in FY 1986. (Table 13).

Moreover, additional costs are incurred by society from an increased volume of illegal imports when Customs staff is cut. Illegal imports result in lower output by U.S. firms and lower employment by import-competing industries. This loss of job and output translate into reduced tax receipts for the Federal government.

NTEU has made estimates, presented in Tables 2 and 3, of the output and employment losses associated with illegal imports. Based on these estimates, we have calculated that a $35 million across-the-board cut of U.S. Customs extending over the next six years would result in --

- Illegal imports of $6.5 billion
- 50,000-75,000 jobs lost
- $1.3-$2.0 billion loss in GNP
- $237-$364 million loss in Federal tax receipts
- Lower narcotics seizures.

This is in addition to the $3.0 billion loss in Customs collections already mentioned.

Across-the-board cuts of the U.S. Customs Service entail costs of such severity to society that they should be decisively rejected by Congress.

Customs Continues to Centralize

Customs continues to plan to consolidate ports, districts, and duty assessment locations despite repeated injunctions from Congress not to do so. Banned from taking direct action, Customs is seeking to attain centralization through attrition and selective hiring policies. By not replacing import specialists lost through attrition, hiring replacements only in certain favored ports, shifting the entry workload to those ports, and retaining a single import specialist or entry clerk at less-favored ports to placate their business communities and representatives in Congress, Customs continues to move toward centralization. By banning use of funds for any administrative expenses associated with planning or executing such activities, Congress should reaffirm its clear intention that Customs provide a full staff complement at all existing ports, including increasing staff as required to process growing workload.

Trade Policy Requires Enforcement Resources

This year, Congress will conduct a major review of the nation's trade laws. Enforcement should be an important part of this review. Our trade laws are not self-enforcing; they must be policed in order to be effective.

As Congress considers changes in trade policy, it should ask itself the question, 'What is the ability of the Customs Service to enforce new requirements?' Congress should direct Customs to prepare enforcement impact statements, together with additional resource needs, for any major changes in trade policy.

Under the Multifiber Arrangement, Customs keeps track of over 600 different quotas on textiles and apparel from 34 different countries. Voluntary Restraint Agreements are in effect with 24 countries under the President's Steel Program. Under the Generalized System of Preferences, more than 3,000 products from 103 developing countries are eligible to enter the U.S at lower rates of duty. The Caribbean Basin Initiative authorizes duty-free treatment for a variety of products from the 21 nations and territories of that region. Anti-dumping and countervailing duty orders are on the upswing; these must be enforced by Customs. Virtually all of the statistical data on which trade policy is based is obtained by Customs.

In the past, Congress and the Executive Branch have not paid sufficient attention to enforceability as they have written trade legislation and negotiated trade agreements. For example, every one of the 55 bilateral and visa agreements under the Multi-Fiber Arrangement is different, making proper classification of imports a matter of considerable complexity. Many of our bilateral agreements contain exemptions for folklore and handicraft products that are difficult to enforce.

Section 807 imports from Carribean countries of garments manufactured from cloth prepared in the U.S. require detailed records examinations to properly determine admissibility. Due to insufficient staff, Import Specialists are not allowed to conduct these exams before admitting such products into our markets. The American Textile Manufacturers Institute has presented evidence to Customs showing that far more Section 807 imports are being returned to this country than the quantity of cloth exported would allow. Customs says that its audits are not uncovering any understatement of quantity. A few cases only have been found of Section 807 imports made from cloth of Asian origin. Obviously, once the goods enter the stream of commerce, they commingle with other apparel and can no longer be identified.

It is Congress' duty to ensure that there are sufficent number of textile Import Specialists, armed with access to records, to make a valid admissibility determination prior to entry of merchandise. There should also be sufficient Inspectors to physically inspect an adequate number of shipments. Today, 98 percent of containerized shipments enter the country without inspection. If we are going to have an 807 program, let's provide the resources to make sure it isn't abused.

Similarly, when Congress enacted authority in the Tariff and Trade Act of 1984 to bar European Community steel pipe and tube imports until a voluntary restraint agreement was negotiated, the resources to monitor and inspect these imports should have been provided.

Trade policy requires enforcement resources. As

Congress fashions new trade legislation, it should keep in mind the enforceability of its provisions. Customs should be required to provide Congress regularly with "enforcement impact statements", showing the funds and staff-years required to enforce new provisions of the trade laws.

Voluntary Compliance with Customs Laws is Low

Today, the enforcement climate in the trade community is not good. The majority of exporters, importers, and brokers are honest and reputable. Nevertheless, there seems to be an attitude on the part of many foreign exporters, and of some importers and brokers, to 'take all you can get away with.'

Deteriorating compliance has fostered growing contempt and abuse of the Customs laws. Customs bonds, posted to ensure compliance, are forfeited routinely as a cost of doing business. Some importers play a game of cat and mouse, port shopping or submitting erroneous entries on the chance they won't be caught. When discovered, the most frequent penalty they incur is detention of their shipment until the error is corrected or a correct visa or export certificate is obtained.

The economic reward for cheating is huge. The chance of getting caught is slight. The penalties, once caught, are also slight. The idea that 'everyone's doing it' is a handy rationale.

Consequently, the incentive for commercial fraud is very large.

The incentive is big enough to cause some firms and individuals to commit criminal acts and submit fraudulent documents to Customs. Names like Mitsui, Daewoo, Thyssen are among those who have been apprehended. The Dingell Committee described a meeting between Hitachi officials and an FBI undercover agent:

> "As recorded on tape, the FBI undercover agent asked senior Hitachi engineers how they planned to get past Customs what they believed to be stolen IBM component parts, which were the size of a pool table. Amidst laughter, the Hitachi officials stated that U.S. Customs is no problem".

Steel fraud is pervasive. The Chairman of the Steel Caucus, Senator John Heinz, told the Dingell Committee that there are currently 40 active cases of steel import fraud under investigation. Describing the lack of physical facilities at U.S. ports for detecting fraud, and lax enforcement resulting in only minor slaps on the wrist, Senator Heinz concluded that:

> "Investigations proceed at snail pace, fines are inconsequential, convictions rare, resources shrinking and the deterrent nill. Our government has unwittingly issued an invitation to 'fraud without fear'".

The Reagan Administration bears the entire responsibility for this sorry state of affairs. Each of its budgets in the last six years have recommended cuts in the Customs Service. The most Congress has been able to do is keep resources from falling. As a result, Customs resources have remained static during the largest growth of imports in recent history. In some ports which have experience enormous growth, such as Los Angeles, Portland, and Seattle on the West Coast, and Houston on the Gulf, resources have actually declined.

The Administration has talked enforcement but practiced facilitation. Its policy is to accept 85 to 98 percent of the shipments without inspection. It requires Import Specialists to 'bypass', i.e., not reveiw, 70 percent of all entries. By these policies, it has dismantled the barriers that deter evasion and created the conditions for rampant commercial fraud. It has deprived American citizens of the protection of their laws.

Not until the sanctions for evading the Customs laws are greater than the incentives to cheat will commercial fraud be reduced. The odds of getting caught must be raised significantly by increasing the number of Inspectors, Import Specialists, and Special Agents. The penalties, once caught, must be more severe. Examples must be made of those who practice customs fraud. Attenpts at 'avoidance', as contrasted to evasion, (for example, by wrongly classifying an item in a lower duty category), that Customs has allowed to pass as long as the error is corrected, should incur a penalty. Criminal sanctions and forfeitures of goods, rather than mere detention, should be imposed where the responsible party should have known better.

Voluntary compliance with the Customs laws is at a low level. Two years of hearings by the Dingell Committee confirm the widespread extent of commercial fraud. The Committee found billions of dollars in counterfeits that made their way past Customs into U.S. markets. It unearthed extensive abuses in bonded shipments and foreign trade zones, where lax accountability as well as virtually non-existent Customs inspection permitted goods to illegally enter U.S. commerce.

After the Mitusi case, which was only discovered through an informer, Customs was astonished at the amount of steel fraud that was occuring. A story by Steve Goldberg of Media General News Service quoted a U.S. trade official as saying that Customs could assess fines against "one Japanese trading company a week if they had resources."

Two years ago, the New York Region reported that textile fraud had reached 'epidemic proportions'. The Barnard Committee investigation last year confirmed this situation. Its report, "Federal Enforcement of Textile and Apparel Import Quotas," is a classic description of the widespread quota fraud that exists today.

Last year, Customs discovered a fraudulent drawback scheme that allowed 506 million pounds of sugar to enter the U.S. market illegally. This single scheme involved evasion of duties estimated at $50 million.

None of this detracts from the outstanding performance of the individual men and women of the U.S. Customs Service. The Dingell and Barnard Committees, and testimony by the private sector, have commented repeatedly on the competence and dedication of these splendid men and women. As the Dingell Committee concluded, "There are just not enough of them."

Customs has pointed to increased seizures as evidence of enforcement effectiveness. But increased seizures mean better enforcement only if illegal supply is reduced by virtue of a smaller amount of illegal imports getting by Customs. The evidence developed by the Dingell and Barnard Committees is to the contrary. The affected industries have also blown the whistle on Customs, sending their own investigators to find warehouses full of counterfeit and fraudulently imported products.

Only by tightening enforcement, punishing wrongdoers, and deterring others by raising the odds of getting caught and raising the costs of evasion, can voluntary compliance be restored to a high level. Congress should see to it that Customs is given the resources it needs to do the job.

Commercial Fraud Is Widespread

Last year, in response to an inquiry by the House Ways and Means Committee, Customs provided an estimate of total commercial fraud for the period 1985-1990. At the same time, NTEU obtained a Customs staff estimate of goods imported but not reported, and undiscovered due to the low rate of inspection. This data is presented in Table 2, which shows the total commercial fraud threat for 1985-1990.

The data show that commercial fraud will rise from $36.875 billion in FY 1985 to $38.719 billion in FY 1990. We believe this to be a conservative estimate. We project no increase in the volume of unreported goods. We accept Customs estimate of $12 billion for counterfeit imports even though the International Anti-Counterfeiting Coalition estimates $20 billion annually. Customs estimates for steel fraud (about a million tons a year out of 15.4 million imported) and textile and apparel fraud (about 300 million square yards equivalent out of 10.845 billion imported) for 1985 are surely conservative.

At the Barnard Committee hearings, then Assistant Commissioner for Commercial Operations, Donald Schaeffer, stated that a total universe of commercial fraud of about $40 billion or about 10 percent of U.S. imports seemed to be a reasonable estimate.

The Customs Quality Assurance Program is a system of measuring, by sampling, the errors in formal entries. GAO reviewed this program last year and found serious deficiencies (U.S. Customs Service: Import Specialist's Duties and Reviews of Entry Documentation, GGD 85-45, March 29, 1985). Nevertheless, program data showing low error rates on entries are sometimes used by Customs to evidence a high degree of compliance.

This approach to measuring compliance is quite wrong. As the Dingell Committee noted, the entries submitted in the Mitsui case were perfect -- and totally false. Without verifying entry data through physical inspection and sampling of shipments, foreign exporters are essentially on an honor system. The paperwork may be in order, but the shipment may not correspond to the paperwork. Only through physical inspection in conjunction with review of entry documents is it possible to have a valid compliance measurement system. Customs has thus far been unwilling to implement such a system, even though it conducts sufficient inspections to make compliance estimates feasible.

As a result of commercial fraud, it is conservatively estimated that Customs loses $3 billion annually in uncollected duties (Table 2). Based upon the large number of entries (about 70 percent) bypassing Import Specialist review, and the small number of inspections (2-15 percent of shipments), NTEU believes voluntary compliance is no better than 50 percent at the present time. Since Customs collects about $15 billion annually, each percent change in voluntary compliance is equal to $150 million. If compliance is 50 percent instead of 90 percent as Customs avers, this implies a revenue loss of $6 billion annually. NTEU believes $3-$6 billion is a realistic estimate of revenue loss from non-compliance with Customs laws.

Commercial Fraud Costs the Nation Dearly

In a working paper prepared in January 1986, Kan Young, Ann Lawson, and Jennifer Duncan of the Office of Business Analysis, Department of Commerce, used input-output tables to estimate the total effects of trade (exports as well as imports) on an industry's employment and output. NTEU has extended their analysis to estimate the economic impact of illegal imports on jobs in the economy. Our results are summarized in Table 3. We found that 438,000 to 688,000 jobs are lost from illegal imports. Conservatively, illegal imports are costing the economy nearly a half million jobs.

Of this loss, 144,000 jobs are in the textile and apparel industry, 51,000 in the leather goods industry, 32,000 in primary iron and steel, 76,000 in electrical and electronic equipment manufacturing, and 42,000 in motor vehicles and equipment.

It is estimated that the output loss equivalent to this job loss is $8-$12 billion in GNP. Between FY 1985 and FY 1987, the Budget of the U.S. Government projects GNP to increase from $3,992 to $4,629 billion, and Federal budget receipts to increase from $734 to $850 billion. Thus, each billion dollars change in GNP changes Federal receipts $.182 billion. The total loss of Federal revenue for an $8-$12 billion loss of GNP would be $1.46 to $2.18 billion annually for as long as illegal imports continue at current levels.

To summarize, we estimate that commercial fraud is costing the nation each year:

- $3 billion in lost Customs revenues
- $19 billion in lost sales
- $8-$12 billion in lost GNP
- 500,000 lost jobs
- $1.5-$2.2 billion in lost Federal taxes

Only a Small Part of Commercial Fraud is Caught

The recent Economic Policy Council Report (Baker Report) to the President on textile imports permits an estimate to be made of how much commercial fraud is being caught by Customs. The report states that

Customs seized $31 million in illegal textile imports in FY 1984 and the same amount in FY 1985. The FY 1984 figure was a 300 percent increase over FY 1983.

There were 389 seizures in FY 1985, and the report estimates that detentions (not releasing a shipment until a correct visa is obtained) and redeliveries (returning a shipment to Customs control due to a violation discovered after release) were at least 30 times the number of seizures.

The report states that Customs currently has under investigation $242 million in textile trade for quota fraud. Some of these cases involve entries going back to 1981. However, we can assume most of the cases were opened after Operation Tripwire was established in FY 1984.

Thus, in the two years since Customs intensified its textile fraud efforts, it successfully removed $62 million in illegal textile and apparel imports from the market. An unknown amount was also removed through redeliveries, but according to the report, "these actions are not included in enforcement statistics." We believe this is the case because redelivery is a largely ineffective method of enforcement. Once goods have entered the stream of commerce, they are virtually imposssible to retrieve.

According to Customs data in Table 2, the amount of textile fraud was estimated at $450 million in FY 1985, or $900 million over FY 1984-1985. Total seizures of $62 million represent 7 percent of the estimated fraud that was caught, in terms of illegal goods removed from the marketplace.

Using the $242 million in quota fraud under investigation (this figure would include the $62 million in seizures), Customs is catching 27 percent of estimated fraud in textiles and apparel.

Evasion Methods: Textiles and Apparel

By examining two trade-sensitive products, textiles and steel, a variety of schemes can be detected by which the customs laws are fraudulently evaded. Patterns of evasion are naturally shifting in response to Customs enforcement efforts. But due to inadequate numbers of Inspectors and Import Specialists, all of these schemes are being practiced today.

In textile and apparel trade, garments are frequently misdescribed in import documents to qualify for a lower duty or a more available quota. Misdescription accounted for 60 percent of the volume of seizures for quota fraud in FY 1985. Men's garments may be described as women's or unisex when the men's category is filled, and vice-versa. All this requires is a one-word change in the invoice.

In some cases, garments are slightly modified to justify a false description. Flimsy liners are tacked into men's shorts which are then described as swimwear.

Bibs are loosely stitched onto girls' jeans and described as overalls. Panels have been loosely stitched to shirts, which are then described as dresses. In these cases, a false value is sometimes declared to bring the invoice value in line with the description.

Understatement of quantities and weights accounted for 24 percent of quota fraud in 1985. This practice allows unreported goods to falsely enter the marketplace, minimizes collection of duty, and misrepresents the amount that should be charged to the quota. According to Customs, it is a common practice.

Transshipment of a product through another country that has no quota or has an available quota, after marking with false country of origin, is another common practice. Although seizures under this scheme represent only 8.8% of seizures made in 1985, Customs estimates that this is one of the most frequently used schemes in textile and apparel fraud. It is a difficult and time-consuming scheme to prove, involving investigations in several countries, some of which refuse to cooperate with Customs. Information on transshipment is often not available until after release of the goods. Congress should require, as a condition of access to our markets, that our trading partners cooperate fully and exchange information with Customs to detect violations of this sort.

Declaring false fiber content is another fraudulent practice, accounting for 5.4 percent of textile fraud in 1985. Certain fibers, such as linen, silk, and ramie are not subject to quotas under the MFA. Laboratory analysis and extensive analysis of cost data are required to determine correct fiber content . Shipments are not detained until completion of the analysis because, according to Customs, they cannot be detained on mere suspicion. As a result, they are in distribution channels by the time a determination is made.

Prompt laboratory analysis is essential for proper classification of merchandise and enforcement of quota restraints. Yet Customs has been reducing laboratory staff and capability for a decade. in 1976, 190,000 samples were tested. By 1984, the number had fallen to 85,000 and the statistical series was terminated in the Customs budget. Without doubt, Customs laboratory capability needs expansion for effective enforcement of our trade laws. The present turnaround time of 45-90 days for sample analysis is too long to permit contemporaneous or near-contemporaneous admissibility determinations, which should be the goal.

Split shipments is another form of evading textile and apparel quota limits. Shipments valued at $250 or less and accompanied by visa exempt certificates may enter without being charged to quota. On one occasion, 40 different shipments consigned to the same importer arrived on the same day. Investigation of informal entries found widespread abuse of the exempt certification to split large commercial shipments and evade quota levels. Customs also found undervaluation and understatement of quantities on many of these entries.

Operation Split, which was conducted at six Customs international mail facilities in November, 1985 resulted in 600 detained parcels, 105 seizures, and 2 criminal cases accepted for prosecution. Stronger enforcement at mail facilities on a continuing basis is not possible due to insufficient staff. Customs examined 12.5 percent of all mail packages received in 1979. Today it examines 6.2 percent.

Customs conducted a survey of 43 ports last year to determine the extent of use of exempt cerfications. It found that 1,139 exempt certifications were cleared each day accounting for 2,173 dozen garments per day. This amounted to over 500,000 dozen garments entering each year with no charges being made to quota.

Customs recently promulgated a new regulation requiring all such textile and apparel shipments to be treated as formal entries. The regulation originally required "live entry" procedures to be followed, meaning that the shipment could not be released until the entry was presented to an Import Specialist for approval. Customs had to backtrack on this last requirement, however, becasue of insufficient staff.

Evasion Methods: Steel

As a result of the President's Steel Program, the European Community Steel Pipe and Tube Agreement, and voluntary restraint agreements (VRA's) concluded for specialty steels, virtually every finished or semi-finished steel product imported from another country must enter under a specific quota for that product and country. The President's Steel Program is scheduled to remain in effect until October 1, 1989.

There are four primary evasion methods in the steel trade:

(1) use of false exports cerficates or reuse of a properly issued certificate for more than one shipment (under the restraint agreements, a certificate issued by authorities in the exporting country must accompany each shipment);

(2) importing tonnage in excess of that described on export certificates and other import documents;

(3) falsely describing the product so it appears to be a product not covered by the VRA, or falls into a VRA product category that has a larger allocation than the true category;

(4) transshipping the product through a country not covered by a VRA and falsely declaring the country of origin.

Customs has responded to these schemes by developing a method of verifying export certificates, and spot-checking to determine overweight shipments. While hundreds of truckloads of steel were weighed in Operation Heavy Metal last November, only 4 seizures were made for overweight shipments. The American Iron and Steel Institute has recommended that weighing be regularly conducted at each major steel port. Customs hs few scales at the present time.

Customs lacks the capability to deal effectively with evasion through product misdescription and transshipment. The variety and quality of steel are expanding as technology advances. There are now more than 450 different kinds of alloy steel, and none can be properly identified unless a mobile metal analyzer (MMA) is used. Three of these instruments are now based in Customs labs at Los Angeles, New Orleans, and Chicago. Houston, the largest steel port in the nation, does not have an MMA. One is required at Savannah to serve the southeast ports, and at New York to serve the northeast. A second MMA is also required on the West Coast. Congress should require Customs to purchase 4 additional MMA's (at $60,000 each) and deploy them with technicians as soon as possible.

Transshipment and false country of origin declaration is a growing problem. Many nations of the world have fully integrated steel production capacity (production of all forms of steel from semifinished blooms, billets and slabs to highly fabricated, finished products.) Almost every nation has some capability to frabricate basic products such as nails, sheet, strip, wire, rope, etc. Many of these basic products are covered by VRA's.

In 1985, of the 15.4 million tons of imported steel, 12 million tons came from countries which were covered by VRA's. The transshipment concern is with the other 3.4 million tons. Of this amount, 2 million tons comes from Canada. Other traditional suppliers (Sweden, Austria, Taiwan, Argentina, Norway, Yugoslavia) account for another 1 million tons. The final 300,000 tons includes some traditional and most of the new supplier nations.

Customs is concentrating its efforts against transshipment in two areas: Canada because of its proximity and large volume of steel trade, and Caribbean nations because of the added incentive of duty-free treatment under the Caribbean Basin Initiative. The U.S. and Canada have agreed to share information and assist each other in tracking transshippers. The problem is two-way, as some steel entering the U.S. is illegally exported to Canada in violation of that country's restraints on country of origin. U.S. and Canadian cooperation has led to several investigations underway. Some are beginning on shipments through Caribbean countries.

Customs Resources are Insufficient for Commercial Fraud Enforcement

Voluminous testimony has been compiled by the committees of Congress, including Ways and Means, Finance, and Appropriations as to the general insufficiency of Customs resources to properly staff the ports of entry, process entries, and enforce the Customs laws. All objective observers agree on this point. The only party that seems to disagree is the Administration.

NTEU has for nearly a decade been calling attention to sharply deteriorating enforcement capability that is the consequence of fundamental imbalance between growing workload and static resources. We have pointed to the huge social costs of non-enforcement. We have stressed our belief that the proper question was not whether enforcement "costs too much", but whether the nation can afford the costs of non-enforcement.

In the analyses which have accompanied our testimony, we have demonstrated that significantly larger numbers of Inspectors, Import Specialists, Patrol Officers and other personnel are required. Of late, independent corroboration of this finding comes from other sources, such as the Port Authorities of Los Angeles, Houston, and Seattle, the Air Transport Association, the American Textile Manufacturers Institute, and the American Iron and Steel Institute.

In June and July, 1985 a task force of steel industry experts from the American Iron and Steel Institute visited the ports of Los Angeles, Houston, Hartford and Detroit to view steel operations. Their first-hand report demonstrates the insufficiency of Customs resources to administer the steel program. Excerpts from the report follow:

> "The lack of sufficient personnel in Operations in Los Angeles has resulted in a substantial backlog in processing and forwardng to the Census Bureau data for inclusion in Census' monthly import statistics. This backlog, in turn, has resulted in confusion over the accuracy of the Census import statistics and has engendered unnecessary friction with the Administration on the efficacy of the President's steel program."
>
> "The Task Force also observed in Los Angeles and Houston tht the Operations Departments did not have sufficient personnel to deposit duty checks the same day as they were received. It is estimated that delays in depositing checks at these two ports resulted in lost revenue to the US. Treasury of more than $7 1/2 million per year. Thus, the hiring of more personnel would immediately pay for itself many times over."
>
> "Staffing of import specialist teams is at a critically low level at all of the ports the Task Force visited. The IS's were so overburdened as to be substantially less effective than their capabilities should permit."
>
> "Of the four ports the Task Force visited, the Houston, Detroit, and Los Angeles steel IS teams did not have clerical support staff. As a result, IS's in these ports spend a considerable amount of time typing memo's, xeroxing, delivering and picking up documents, etc."
>
> "A major shortcoming of all of the import specialist operations which we observed is the lack of time spent on the docks by the IS's. The principal reason why the IS's do not go to the docks more than once a quarter in Hartford, for example, or almost not at all in other ports is due to the shortage of IS's and clerical help noted above. We believe that increasing the IS staff and adding clerical help at major ports would free the IS's to assist the inspectors on difficult-to-classify or questionable importations."
>
> "Further evidence of the value of having experts in steel identification on the docks with the

> inspectors comes from the Task Force's tours of dock operations. In each port we visited we randomly "inspected" imported steel shipments -- without looking at confidential documents -- and in each port of entry we found at least one shipment which was close enough to classification break points to justify sampling."
>
> "The most important recommendation which the task force makes regarding enforcement is that IS's work on the docks and assist the inspectors more frequently. IS's have extensive training on product identification -- some of which has been provided by the AISI -- and a closer working relationship between IS's and inspectors which would develop from such a system should improve enforcement of the President's Program immeasurably."
>
> "Two of the four ports visited were in obvious need of more inspectors. In one port -- L.A. -- virtually no steel is inspected on a routine basis due to the shortage of personnel."
>
> "The Task Force recommends that the C.S. hire additional inspectors for the ports of Los Angeles and Houston. An important additional recommendation is for the C.S. to ensure that there is sufficient clerical help at the inspectors' offices to free inspectors for their critical dock work. And it is especially important for there to be sufficient clerical help at ports where the ACCEPT System has been automated."

More Inspectors are Needed to Deal With Commercial Fraud

Since the insufficiency of Customs resources is generally recognized, the only question is the required level of resources for the immediate future and for the long term. To this end, NTEU has projected Inspector requirements for cargo processing to 1990 by using Customs historical data, projected entry workload, and 3 percent annual productivity growth. Since 1983 was a year of above-average productivity growth, measuring productivity from that base will yield a conservative estimate of the cargo processing staff in future years.

The analysis is presented in Table 8. It shows that a minimum of 600 more Inspectors are required for cargo processing in FY 1987 than in FY 1986, and 1100 more in FY 1990 than in FY 1986. It should be noted that these numbers are the minimum required to maintain the current rate of inspection, with a 3 percent improvement, due to the growing workload.

NTEU's recommendation of 400 additional Inspectors for FY 1987 should be considered as the first installment of a long-range plan to raise the number of Inspectors by 2,000 by 1990. The remaining 900 Inspectors are required for passenger processing, narcotics interdiction, and to significantly increase the current cargo inspection rate.

A significant number of additional Inspectors should be used to double the containerized shipment inspection rate (shown in Table 9) from 2 % to 4%. It is important that this rate be raised to a minimum of 10 percent as soon as possible.

Merchandise inspections generally should also be increased. The total number of merchandise inspections stood at 11.3 million in FY 1979 compared to 10.9 million in the current fiscal year. But the number of entries has increased 61 percent, and inspections per entry have fallen nearly the same amount.

ACCEPT

ACCEPT stands for Automated Cargo Clearance and Enforcement Processing Technique. It is a computerized system tht is supposed to employ national and local criteria provided by Import Specialists and other sources to identify high-risk shipments for inspection, while low-risk shipments are released without inspection. ACCEPT is now in the process of being integrated into the Automated Commercial System which will track and control all Customs commercial operations.

NTEU continues to have serious reservations about ACCEPT. Our reservations are as follows:

1. ACCEPT's plain objective has been to reduce the number of shipments to be inspected to the capability of the available manpower. It has never determined more "high risk" shipments than the manpower available to perform inspections would permit. It has never identified, or verified, the true number of "high risk" shipments and used this figure to compute the number of Inspectors required. ACCEPT starts from the premise that 20 percent of shipments will be screened for possible inspection; the remaining 80 percent will be released without inspection. Of the 20 percent, many are designated for "general exam" because of shortage of available manpower. In practice, general exam means release without

inspection. The number of shipments designated for "intensive exams" is frequently less than 10 percent. For cargo containers, the figure is 2 percent. Under ACCEPT, shipments not designated for intensive exam are not "high risk" by definition. Many shipments that should have been inspected were released without inspection, because ACCEPT was a hastily improvised means of reducing workload at a time (1983-1985) when imports were rising sharply. As a result of this system of controlling inspections, commercial fraud grew rapidly. ACCEPT is a rationalization for non-enforcement, while commercial fraud mounts.

2. ACCEPT does not permit full exercise of the Inspectors's professional judgement. Someone else reviews the entry documents and determines what shipments to inspect. The shipments designated for inspection are indicated to the inspector on a computer terminal. Because he lacks the entry documents, cargo mainfests, waybills and other sources that formerly he would have available to judge if everything was in order about the shipment, he is limited in his ability to override the computer and in his ability to perform an adequate inspection. Since the documents are in someone else's possession, he must often make the inspection without the paperwork that might have indicated what to look for. Many products are

produced in one country, sold by an exporter in another country, and can be loaded in a third country. Correlating information from the shipping documents can help the Inspector make an effective inspection. That is not possible under ACCEPT, because the computer is not used as a tool to assist the Inspector, but as a means of allocating workload. Bear in mind that 80 percent of shipments have already been cleared for no inspection. In principle, the Inspector can override the computer's decision and upgrade a general exam to intensive. In practice, the override is more frequently from intensive to general due to insufficient Inspectors. Customs is either unwilling or unable to provide data on the number of inspections, or on the number of overrides, despite NTEU's request.

3. The criteria to be input to the computer are not sufficiently developed or refined to accurately identify "high risk" shipments. In our opinion, adequate criteria will not be available for another 5 years, if at all. It is not possible to set up a computerized system for fingering shipments to be checked without a great deal of data collection and construction of profiles of "high risk" shipments and "high risk" importers. Customs is far behind in collecting the data and constructing the profiles, let alone

testing them. Customs is also finding that, frequently, suitable criteria are specific to the individual shipment. A soundly conceived system would allow full scope for Inspector's and Import Specialist's judgment, and this is especially important in view of the primitive character of existing criteria. Criteria are the heart of the system. If they aren't adequate, the result will be "garbage in, garbage out".

4. ACCEPT disrupts the Inspector/Import Specialist team, which is the backbone of Customs enforcement. The professional knowledge and judgment of its Inspectors and Import Specialists is the most valuable resource the Customs Service has. In the past, Import Specialists and Inspectors would communicate freely. Inspectors would give Import Specialists valuable information to assist in classifying and appraising the entry. Import Specialists would advise Inspectors what to look for in an inspection, or would join in the inspection. ACCEPT is breaking down this teamwork by reducing communication from Import Specialist to Inspector to stereotyped instructons concerning inspections. Communication from Inspector to Import Specialist consists of stereotyped feedback on inspection results.

5. ACCEPT is not designed as an interactive system that permits Inspectors and Import

Specialists to use the computer as a tool to share information and make joint decisions. It is a command system that directs Inspectors to release 80 percent of shipments without inspections and gives them little say in which of the remaining 20 percent should be intensively inspected. If the computer were used as a tool, enabling Inspectors and Import Specialists to share the same data base, see the same documents, and interact in making the decision to inspect or release, enforcement would be more effective. ACCEPT is not designed this way.

6. ACCEPT cannot correlate intelligence and detect discrepancies in shipping documents to identify new patterns of custom law evasion. Only experienced Inspectors and Import Specialists can do so. The designers of ACCEPT have not addressed this problem.

We submit that ACCEPT should be redesigned from the ground up, with major input from Customs employees. Pending this, Congress should conduct a full investigation of the implementation of ACCEPT and its effectiveness in enforcing the customs laws. Congress should direct Customs to ensure that the Inspector/Import Specialist team is strengthened and not undermined by the introduction of computers.

Customs Inspectors are not opposed to automation. They want the ability to use the computer as a tool to do a better job.

More Import Specialists Are Needed To Deal With Commercial Fraud

With merchandise entries soaring as the nation recorded the largest trade deficit in its history, Customs elected to by-pass 70 percent of the entries, meaning entry documents were not subject to Import Specialist review to ensure proper tariff classification, valuation, and compliance with trade law requirements. In conjunction with minimal inspection, this sharply reduced enforcement placed importers on a virtual honor system and is one of the principal causes of the trade compliance gap.

Customs management has made entry bypass, together with post-audit review of entry documents (meaning audit of a sample of entries months or even years after the goods have entered the marketplace) the basic principle of its commercial operations. Instead of requesting a sufficient number of Import Specialists to properly process the entry workload, Customs has artificially reduced the workload and sought to reduce the corps of Import Specialists. Management has even assigned Import Specialists to a variety of other duties inconsistent with their maintenance of commodity expertise, without which Customs would not be on a par with brokers and others in the trade.

It is safe to say that Customs lacks a clear concept for use of Import Specialists today. As a result, the corps of Import Specialists is demoralized.

Our view is that, while a certain number of entries may be bypassed, this applies to no more than 20 percent of entries at the present time (Table 11). Import Specialists are needed to properly review the bulk of the entries, thereby deterring commercial fraud and protecting the revenue.

Import Specialists are technical and commodity experts who are the backbone of Customs' trade operations. Import Specialists review entry summaries, ensure proper classification of merchandise in accordance with the Tariff Schedules, ensure that shipments are valued properly, scrutinize importations of sensitive commodities to enforce applicable quota or anti-dumping and countervailing duty requirements, make determinations that products are admissible under U.S. law, and enforce the requirements of many other agencies, such as the Agriculture Department and Food and Drug Administration, to ensure that imports are safe for consumption.

Import Specialists ensure that duties are correctly calculated and timely deposited with the Treasury. They are responsible for collecting over $15 billion in annual revenue. It is well recognized by Customs that the more Import Specialists there are assigned, the greater the revenue collection will be.

Import Specialists are in daily contact with the business communities they serve. They hold office conferences with manufacturers and importers to explain

U.S. trade laws and apply their intimate knowledge of legal precedents and ruling to complicated questions relating to proposed importations. They make over 8,000 visits a year to the premises of importers to view product samples, verify invoices, inspect product markings, and explain Customs requirements. These contacts with the business community are an invaluable contribution to the economic health of the region they serve. Moreover, they benefit Customs by assuring fewer errors in entry documents and serving as a deterrent to commercial fraud. Import Specialists are the largest single source of commercial fraud referrals.

NTEU has studied the adequacy of the number of Import Specialists to process the growing entry workload and deter commercial fraud. Our results are presented in Table 10. It shows that while the number of entries will more than double from three million to seven million between 1975 and 1986, the number of Import Specialists is projected to decrease from 1,262 to 966. Assuming an annual average rate of productivity growth of 4.3 percent a year, the number of entries each Import Specialist would be capable of processing in 1986 would be 3,961 entries. Dividing this into the entry workload yields 1,787 Import Specialists as the minimum adequate staff this year. A minimum of 1,836 Import Specialists will be required by 1990.

NTEU recommends that the number of Import Specialists be increased by 300 positions immediately -- 100 additional in FY 1986 by restoring the Gramm-Rudman cut, and 200 additional in FY 1987. Further, Import Specialists should be increased by another 600 positions or 200 a year, over the period FY 1988-90. Only by rebuilding the corps of Import Specialists to a proper level will Customs ever be able to control commercial fraud and properly enforce the nation's trade laws.

In commenting on steel fraud, Senator Heinz has stated:

> "Customs has compounded the problem by proposing a program to drastically reduce the manpower levels of Import Specialists at the same time it has proclaimed import fraud as an area of renewed emphasis. Import Specialists are essential to fraud detection and they need additional support, not lip service. And they certainly do not need cutbacks."

Current Bypass Rates are Highly Excessive

Last year, Customs admitted to bypassing 60 percent of all entries, even though 70 percent of entries were dutiable and a great deal of revenue was undoubtedly overlooked. This year, Customs is attempting to bypass 70% of all entries, even though the number of dutiable entries has risen to 98 percent of entries. (The apparent increase in the number of dutiable entries results from the definition of formal entry being changed in 1985 from a valuation of $250 or more to a valuation of $1,000 or more. Apparently, there were also more small importers who imported dutiable merchandise.)

The present bypass rate is excessive relative to the number of dutiable entries. Customs is failing in its duty to protect the revenue.

Customs says that Import Specialists are required to review all trade program entries, thereby enforcing trade law requirements. NTEU has examined Customs statistics on the number of trade programs in FY 1983 and FY 1985, and has projected the number of such entries for FY 1986. Our results are shown in Table 11.

In addition to trade program entries, Table 11 shows the number of "other agency" entries in which Customs enforces requirements on behalf of the Department of Agriculture, Energy, and Interior; Environmental Protection Agency; Food and Drug Administration; and 35 other agencies. These entries invariably require permits, licenses, and certificates which must be reviewed to verify authenticity. They also are important to the national health and safety. For example, botulism contaminated foodstuffs and unsafe medicines have been kept out of our markets through Customs enforcing FDA requirements. Without doubt, these entry documents must be reviewed by an Import Specialist.

Together, trade program and "other agency" entries will comprise 61 percent of all entries this year. This means that Customs cannot safely afford to bypass more than 39 percent of entries. Yet it is bypassing 70 percent today. This policy has gravely compromised Customs enforcement and torn down the barriers to commercial fraud.

This view was echoed by the Dingell Committee which said:

> "When faced with the problem of unfair trade practices which result in a substantial loss of revenue to the government, the agency has apparently chosen to reduce entry document scrutiny rather than increase personnel.....Part of this system is the 'bypass' program, under which the entry documents are not reviewed at all. There is great pressure on district directors to increase the number of entries on 'bypass'. 'Bypass' guidelines are built into the performance evaluation requirements for Import Specialists in some ports. Even where they are not, the 'bypass' goals often exceed 70 percent of all entries of non-restricted merchandise. To me, this would apear to be a license to steal."

By its excessive bypass rate, Customs has in effect placed many importers on the honor system. Seventy percent of entries are being accepted as submitted by brokers, with audits used later to verify compliance.

We believe this is giving away the store. Customs has documented a long history of significant broker errors: undervaluations and misclassifications that reduce duty and circumvent quota restrictions. This is not surprising because importers, by tradition and instinct, wish to keep duties as low as possible and there has long been a game of cat and mouse between

Customs and brokers. With over 10,000 tariff code classifications, and the possibility of classifying a product in more than one way, the opportunity for self-serving judgements -- unrestrained by any Customs review except post-audit -- would not adequately protect the revenue. Moreover, many tariff classifications can only be properly determined by laboratory analysis, and this cannot be accomplished with integrity after a shipment has entered the stream of commerce.

If a shipment is classified to get around a quota, the damage to the domestic market will have occurred by the time an after-the-fact audit takes place. Import Specialists need to make admissibility determinations and sample the shipment before goods enter the stream of commerce. They can detect quota errors and keep out harmful products. The idea of allowing the importer to be the judge of admissibility is an abdication of responsibility by Customs.

It should be clear from the experience with bypass to date that an honor system won't work. Since bypass was instituted in FY 1983 the country has been deluged with unreported goods and counterfeits. The signal that something was wrong came from the affected industry, which had to hire its own investigators to convince Customs that it was losing business and jobs. A post-audit system can't undo the damage from allowing illegal goods to enter the marketplace.

Centralizing Appraisement Locations Would be Injurious to Trade

It goes without saying that the presence of one or more Import Specialists at a port of entry is of inestimable value to the business community, serves as a stimulus to foreign trade, and may even cause importers, brokers, distributors and warehouses to locate in the vicinity. The closure of Import Specialist offices would constitute a visible downgrading of the stature of the community as a port of entry, and raise justifiable fear of the loss of business to other regions.

We believe that loss of service to the business community is the paramount reason why the Subcommittee should reject Customs' plan to close down full-service entry processing offices at many locations. Customs has not taken adequately into consideration the effect upon the economic health of these communities, nor has it provided the economic impact statement required by executive order.

There are several other cogent reasons why centralization of entry processing is a bad idea. We would like to briefly touch on the most important of these.

First, Import Specialists' physical presence at ports is essential to ensuring that correct data is submitted on entries. One of the most important services of the Import Specialist is pre-acceptance review of entry documents. During these reviews, numerous errors are corrected that increase the number of "no change" liquidations and result in the collection of $53 million a year in added revenue -- more than the cost of the entire Import Specialist work force.

A Customs survey of rejected entries conducted in May 1980 found that 16 percent of all entries reviewed by Import Specialists were rejected due to errors. Classification and valuation errors are the most numerous, and 549 entries of quota merchandise were erroneously presented as not subject to quota. In commenting on this last finding, the director of Customs' Office of Trade Operations stated:

> "The unlawful entry of 549 shipments of quota merchandise would have had catastrophic repercussions."

Second, one of the most important functions of Import Specialists is to make on-the-spot determinations of admissibility. Under normal procedures, most imported goods can be released upon inspection by a Customs Inspector. However, there is a wide range of products for which immediate delivery cannot be allowed because of possible danger to the public health and safety, or economic loss, if the goods enter the stream of commerce. Such goods are quota-class merchandise, manufactures that might infringe on U.S. patents or copyrights, medicines and chemicals that require proper marking, foodstuffs that require Agriculture or FDA certifications to protect consumers, importations that might be in violation of endangered species laws, products that require a license from a U.S. government agency, and shipments that require a country-of-origin determination before entry can be permitted. The presence of Import Specialists at the port, where they can physically inspect shipments and take samples for laboratory testing if required, is essential for proper admissibility determinations. This function cannot be delegated to Inspectors because technical knowledge of commodities, and of applicable Customs rulings and legal precedents, is required.

Third, Import Specialists' personal knowledge of the importer and broker community, together with their ability to verify invoices by visiting premises to inspect purchase orders, vouchers, and records of payment, are important for the detection of commercial fraud and effective enforcement of our trade laws. If Import Specialists are moved hundreds of miles away from the importing community at a port, trade law enforcement is bound to suffer and instances of undetected commercial fraud will multiply.

Fourth, relocation of Import Specialists would break up the Import Specialist-Inspector team that is vital to the smooth operation of our ports of entry. The range of commodities that an Inspector must examine is too great to permit him the expertise needed for a proper inspection and determination of **admissibility.** Consequently, the Inspector depends upon the Import Specialist to provide him with expert information, and the Import Specialist may often join in the inspection. Such teamwork is the bedrock of the entire system. By removing the Import Specialist from close contact with Inspectors, there is a greater likelihood of a shipment being released before its admissibility is determined. Import Specialists can best perform their duties on the line -- close to the trade community and the Inspectors -- and not at some location far removed from the ports of entry.

Fifth, Customs experimented with a similar system of centralized entry processing several years ago. Under this system, Import Specialists at different ports were assigned commodities for which they would have responsibility for classification and appraisement. Merchandise imported at one port might have its entry processed at another port. This experiment proved a complete failure. Not only did it take longer to process the entry, but it became virtually impossible to contact the Import Specialist who was actually responsible for reviewing it.

We believe Customs is now heading in the direction of repeating this unfortunate failure. Under its Automated Commercial System (ACS) it plans to allow entries at one port for shipments arriving at a different port.

Customs asserts that its plan will achieve budgetary savings through reduced overhead, and facilitate automation by permitting larger numbers of entries to be processed at one central location. But automation will be of little benefit to Customs if the entry is not correct. It is the presence of Import Specialists in the trade community that permits a relatively high percentage of correct entries. Moreover, Customs has failed to adequately consider the substantial economic impact on the communities that would lose Import Specialists, and the impact on industry of a reduced capability to detect commercial fraud.

We therefore call upon the Subcommittee to insist that Customs cease at once all current and planned relocations of Import Specialists, to lift the hiring freeze on Import Specialists in districts where such a freeze exists, and to promptly fill vacant Import Specialist positions at ports where such positons are authorized. In its bill, the Subcommittee should direct Customs not to implement any plan for the centralization of entry processing locations.

Automated Broker Interface

The automated broker interface (ABI), when fully implemented, will allow Customs house brokers, representing importers, to electronically transmit data to Customs. The system is being tested now in Los

Angeles and Houston. Customs anticipates that, as more brokers automate, more entry data can be transmitted directly from brokers' computers to the Customs computer.

Concerning ABI, this year's Customs budget states (p.22):

> "Since current procedures require extensive back-up documentation for each entry in order to determine proper classification, the elimination of this requirement for all but the entries selected for intensive review will reduce the amount of paperwork both for Customs and importers and speed up processing."

This statement makes crystal clear that Customs intends to move to a post-audit system for all but trade program entries. Bypass will be accomplished by the computer, and Import Specialists will no longer have access to entry documents which are the very basis of enforcement.

If Customs is permitted to implement this policy, the consequences can only be continued decline in compliance, loss of Federal revenue, increasing illegal imports, and more loss of American jobs.

Import Specialists are not opposed to automation. They recognize the need for a computerized system of reviewing entries. They could assist in designing a much more effective system than Customs has produced to date.

Their reservations concerning ABI are:

(1) There is no substitute for pre-entry review to corrrect broker errors. Customs insists errors will be detected by tolerances and edits in the computer. This is misleading. The fact is that the largest errors -- incorrect tariff classification and incorrect valuation -- cannot be detected. If a broker's clerk makes an error and invoices scissors as tools, the computer will accept the entry and the lower rate of duty. If sugar is invoiced as cookies (as it once was), the entry for cookies will be bypassed, but sugar is under quota.

(2) The importer should not be the judge of admissibility. An Import Specialist should make this determination. Under the bypass system, the importer's determination of admissibility is accepted by Customs, subject only to post-audit. Customs is abdicating one of its paramount responsibilities in foreign trade.

(3) Elimination of the requirement for documentation on entries made through ABI opens up enormous opportunities for fraud and evasion.

(4) Import Specialists should be able to use the computer as a tool to screen all entries, determine those appropriate for bypass, direct the taking of samples, and review all documents in order to verify classification and value, and determine admissibility. In this process, they

should retain the authority to call for copies of invoices, purchase orders, waybills and any other documents that may shed light on the entry.

ABI is the clearest evidence to date that Customs has taken the wrong course. Congress should bar the use of appropriated funds for further implementation of ABI until it conducts a full investigation of this system and its impact upon enforcement.

Narcotics Interdiction

Illicit drug traffic, like commercial fraud, has momentous consequences for our society. The drug threat has increased dramatically. A large amount of narcotics has been successfully interdicted, but more is getting through and the supply remains plentiful (Table 4).

Last year, Customs intercepted 23 metric tons of cocaine, almost twice the amount of a year earlier. About 16 percent of cocaine supply was removed from the market. This achievement reflects great credit upon the men and women of the Customs Service, DEA, Coast Guard, FBI, and local law enforcement agencies.

But larger seizures are also indicators of greater trafficker activity, which means that deterrence is not working. Cocaine supply doubled between 1982 and 1984, and is still increasing. Heroin supply will double this year, according to the Select Committee on Narcotics Abuse and Control. Marijuana supply, almost

90 percent of it from abroad, is the highest on record.

Availability indicators published in the Narcotics Intelligence Estimate confirm that 1984 was a bad year for Federal narcotics efforts (Table 6). Cocaine price fell and purity rose, while hospital emergencies and deaths related to cocaine were twice the number than in 1981. Heroin purity rose while street price remained the same. The number of heroin abusers increased as evidenced by hospital emergencies and deaths. However, both Colombian and Jamaican marijuana prices rose, reflecting successful Customs and Coast Guard interdiction efforts.

There is abundant evidence of the social costs of this traffic in the crime rate, in the job market, in schools and treatment facilities. Here at home, we learn that Montgomery county high school seniors have a rate of cocaine abuse twice the national average. City Councilman John Ray recently pleaded with D.C. residents to eliminate drug abuse which is, in his words, "a form of genocide in the black community." Last year, the U.S. Supreme Court (in New Jersey v. T.L.O.) gave school officials broad power to search students because, said the Court, drug use and violence in the schools are major social problems.

Drug traffickers, and the international terrorists who are frequently their allies, require constant vigilance by Customs.

An idea of the dimensions of the drug threat is provided by the Mexican government's raid on a Chihuahua province marijuana depot two years ago. It resulted in seizure of 9,000 tons of marijuana -- an amount equal to the annual output of Colombia, the world's largest producer. Police confiscated dozens of truck trailers and freight containers and arrested more than 11,000 marijuana pickers, packers, and warehouse workers.

A casualty of the resurgent drug trade has been the National Narcotics Border Interdiction System, headed by Vice President Bush. The system consists of coordinating groups set up in six major cities to better direct the Federal interdiction effort. The difficutly is, as the General Accounting Office has pointed out, a coordinating agency is useless without sufficient assets. The resources of NNBIS are in no way adequate to the task it faces.

Customs Inspectors and Patrol Officers continue to account for a large percentage of total drug interdiction. According to the Select Committee on Narcotics Abuse and Control, Customs Inspectors are responsible for making 57 percent of heroin seizures, 59 percent of cocaine seizures, 70 percent of hashish seizures, and 80 percent of marijuana seizures. Air and Marine Patrols account for large cocaine and marijuana seizures.

Customs still lacks operational capability to detect, intercept, and seize drug intruder aircraft to a degree commensurate with the threat. Table 5 shows Customs data on the narcotics air threat and air interdiction results for 1984. Only about 2 percent of an estimated 2,500 drug flights a year are successfully intercepted. About 11 percent of the cocaine and 2 percent of the marijuana coming by air is being interdicted.

In the face of this crisis, the Administration has requested a reduction of 454 positions in Customs drug interdiction functions for FY 1987. Of these, 420 are Inspector positions. This is the sixth consecutive year in which Congress has had to deal with a totally unrealistic budget request from this Administration. Customs drug interdiction resources have remained static since 1975, and what is needed is a significant increase to deal with the threat as it exists today.

If we are to make headway against traffickers who have demonstrated enormous versatility in shifting their operations from point to point along our 26,000 mile frontier, there is a critical need for additional Inspectors to deter traffickers from smuggling drugs by means of couriers and cargo shipments. This would leave direct air and sea movement as the sole means of border penetration, and traffickers would be vulnerable to our defenses in these areas provided we ensure adequate interdiction capability. At present, trafficking is so extensive and we are so lacking in Inspectors, and in air and marine capability, that the five Gulf Coast governors have called for turning the drug interdiction mission over to the Department of Defense.

The number of Customs narcotics seizures fell from 19,067 in FY 1984 to 15,280 in FY 1985. However, the amount seized was significantly higher. This means that Customs is either using better strategies to cope with trafficker activity, or shipments are coming in larger loads due to increased world supply. In either case, if the number of Inspectors and Patrol Officers were increased, we could expect larger interdiction results.

Restoration of the Gramm-Rudman cut would provide 259 additional Inspectors and 253 additional Patrol Officers for FY 1986. In addition, NTEU recommends 400 additional Inspectors for FY 1987. The same Inspector resources which are used for commercial fraud compliance also serve to interdict narcotics, as cargo inspections are made for both purposes at the same time.

We believe these resources are urgently required in view of the increasing drug threat and the fact that resources have thus far proven inadequate to keep the supply from rising. The cost of additional resources, measured against the costs to society of drug abuse, is small.

Inspectional Overtime

Inspectional overtime has become a critical resource for meeting Custom's growing demands for clearance of passengers and cargo. For nearly a decade, a virtually static inspectional force has had to process a growing number of air travelers and cargo shipments. With its workforce limited by OMB personnel ceilings, Customs inspectional overtime expanded to fill the gap between workload and resources.

An Inspector with overtime earning of $15,000-$20,000 a year works an average of 62 hours a week, 52 weeks a year. A 1981 Customs study of overtime showed that, in addition to a normal 40-hour week, the average Inspector is required to work three of every four Sundays, one Saturday per month, and seven week-day overtime assignments per month. The requirement for this overtime is driven by the demand of carriers for Customs inspectional services during other than normal duty hours of the port. Because of the growing workload and limited staff, it is evident that an extensive commitment to inspectional overtime is essential if Customs is to accomplish its mission.

For Inspectors to make themselves available such long hours, particularly on Sundays and holidays when other citizens are vacationing, adequate monetary incentive must be provided. The most recent data collected by Customs shows that Inspectors are earning, on the average, 2.1 times the regular rate of pay on

Sundays and 2.4 times the regular rate on the other days of the week. The Customs' study attributes the 2.4 rate of pay to the call-back of Inspectors who have left the worksite. Such call-backs frequently occur at night and at irregular hours, taking a physical toll on the Inspector. The study also confirms that the average Inspector works 7 hours on each Sunday assignment, and an average of 8 hours if holidays are included in this figure.

We are convinced that the frequent call-backs, the late-night hours spent away from home, and the physically demanding nature of inspectional duties justifies the present rate of overtime pay. Moreover, these rates of pay conform with the prevailing overtime rates in the private sector which normally establishes double time premiums for call-back and night work, and where the typical practice is triple time for Sunday overtime and double time and one-half for holiday work.

We urge the Subcommittee to remove the $25,000 cap on Customs Inspector overtime earnings. The overtime cap has long outlived its usefulness.

Proponents of the cap claim to be acting in the employee's interest by limiting the amount of overtime Inspectors could be compelled to work. However, the overtime cap had exactly the opposite effect and completely eliminated the voluntary aspect of overtime. This is because Inspectors are required to rotate overtime assignments so that the earnings of all can be equalized.

Customs itself has urged Congress to remove the overtime cap. Treasury Department officials have testified that, in addition to costing $1 million a year to administer, the cap is preventing Customs from properly allocating its limited resources among ports experiencing different rates of growth.

Delegation of authority to waive the cap has been granted to Customs by Congress. We submit that the time has come to remove the cap completely, in favor of Customs internal controls. We strongly urge the Subcommittee to adopt this course of action.

Summary of Recommendations

In conclusion, NTEU recommends that Congress:

- Require Customs to provide "enforcement impact statements" containing funds and positions required to enforce new provisions of the trade laws;
- Require our trading partners to cooperate fully with Customs in investigating trade law violations;
- Provide an additional $77 million and 2,147 average positions for Customs over the Administration's FY 1987 budget request (Table 1);

- Restore the Gramm-Rudman cut by appropriating $35 million and 777 average positions for Customs for FY 1986 (Table 1);

- Bar the use of appropriated funds for any administrative expenses associated with planning or executing centralization of appraisement staff or consolidation of ports, regions, or districts;

- Require Customs to provide a full staff complement at all existing ports, including increased staff as required to process growing workload;

- Conduct a full investigation into Customs major policy directions, such as bypassing 70 percent of all entries and relying upon post-audit reviews for enforcement; admitting more than 80 percent of shipments without inspection; centralizing functions such as appraisement; reducing the number of Import Specialists; ACCEPT; ABI; and the audit/inspection system for in-bound shipments, bonded warehouses, and foreign trade zones.

- Increase penalties for non-compliance with the customs laws in order to significantly raise the cost of evasion and deter commercial fraud;

- Increase Customs laboratory staff and capability in order to provide a 30-day response time to requests;

- Procure 4 additional mobile metal analyzers for use in ensuring proper classification of steel imports;

- Strengthen Customs enforcement at international mail facilities to deter textile quota evasion through split shipments;

- Authorize an increase in the number of Import Specialists from the current 900 positions to 1,800 positions by 1990;

- Require in legislation that Import Specialists review a minimum of 70 percent of all entries, and that no more than 30 percent of entries by bypassed;

- Bar the use of appropriated funds for administrative expenses associated with planning or executing elimination of the requirement for brokers to submit, and Import Specialists to review, backup entry documents for entries processed electronically under ABI;

- Bar the use of appropriated funds for further implementation of Automated Broker Interface (ABI) pending completion of a full congressional investigation of this system and its impact on enforcement;

- Strengthen Customs narcotics enforcement by significantly increasing Inspection and Tactical Interdiction resources; and
- Remove the present overtime cap from legislation.

Mr. Chairman, this concludes my statement. Are there any questions?

TABLE 1

U.S. CUSTOMS SERVICE FY 87 BUDGET REQUEST AND NTEU RECOMMENDATION

(Amounts in Thousands of Dollars)

	FY 87 BUDGET REQUEST		ADD-ON REQUIRED FOR RESTORATION TO FY86 CR LEVEL		RECOMMENDED BASE-LINE FOR FY 87 APPROPRIATIONS		NTEU RECOMMENDED ADDITION		NTEU RECOMMENDED APPROPRIATION	
	Amount	Average Positions	Amount	Average Positions	Amount	Average Positions	Amount	Average Positions	Amount	Averag Position
Inspection and Control	307,475	6,176	+25,614	+757	333,089	6,933	+14,000	+400	347,089	7,33
Tariff and Trade	174,847	2,890	+9,264	+322	184,111	3,212	+7,000	+200	191,111	3,41
Tactical Interdiction	104,311	1,701	+11,294	+303	115,605	2,004			115,605	2,00
Investigations	106,367	1,727	+5,790	+165	112,157	1,892			112,157	1,89
SUB-TOTAL	693,000	12,494	+56,131[a]	+1,547	749,131[a]	14,041	+21,000	+600	770,131[a]	14,64
Operation & Maintenance, Air Interdiction Program	54,700				77,200[b]				77,200[b]	
TOTAL	747,700	12,494	+56,131	+1,547	826,331	14,041	+21,000	+600	847,331	14,64

[a] Includes restoration of FY 86 rescission of $4,169,000

[b] Includes restoration of FY 86 rescission of $19,275,000 and GRH cut of $3,225,000

TABLE 2

COMMERCIAL FRAUD THREAT TO THE U.S., FY 85-90

(In Billions of Dollars)

	1985	1986	1987	1988	1989	1990
Goods Imported but Unreported (est.)	25	25	25	25	25	25
Counterfeit Goods[1]	10.5	11	12	12.5	12	12
Goods Imported in Violation of Trade Agreements[1]						
Steel	.550	.525	.500	.575	.600	.625
Textiles	.450	.473	.495	.518	.540	.563
Other[2]	.425	.446	.468	.488	.510	.531
Sub-Total	1.375	1.444	1.513	1.581	1.650	1.719
Grand Total	36.875	37.444	38.513	39.081	38.650	38.719
Estimated Revenue Loss[3]	3.0	3.0	3.0	3.0	3.0	3.0
Est. Sales Loss to U.S. Firms[4]	19	19	19	19	19	19
Est. GNP Loss[5]	8-12	8-12	8-12	8-12	8-12	8-12

[1] U.S. Customs Data

[2] Includes Electronics

[3] The average rate of duty on dutiable imports is 8%. Applying this rate to $38.6 billion yields a conservative estimate of the revenue loss, as fines, penalties and forfeitures, in addition to duties, would be involved in actual cases.

[4] ITC estimate for conterfeit goods alone in $6 billion. To this is added one-half of unreported goods and goods imported in violation of trade agreements.

[5] Manufactured imports were $300 billion in 1984, and illegal imports of $40 billion would raise this amount by 13.3%. A Department of Commerce analysis found a loss of from $60 to $90 billion in GNP as a result of the trade deficit (exports minus imports) in 1984. Assuming these losses would increase in the same proportion as the increase due to illegal imports, there would be an additional loss of $8-$12 billion in GNP.

TABLE 3

JOBS LOST FROM ILLEGAL IMPORTS IN SELECTED MANUFACTURING SECTORS, 1984

	LEGAL IMPORTS (Billions)	TOTAL EMPLOYMENT (000)	EST. ILLEGAL IMPORTS (BILLIONS)	NET JOBS LOST FROM LEGAL TRADE[1]	ESTIMATED JOBS LOST FROM ILLEGAL IMPORTS[2]
Textiles & Apparel	23.640	1915	5.04	674,000	144,000
Rubber & Misc. Plastics	6.653	763	1.40	89,000	18,700
Leather	8.819	176	1.88	238,000	50,700
Primary Iron & Steel	12.022	512	2.56	148,000	31,500
Primary Nonferrous Metals	11.341	299	2.40	95,000	20,100
Fabricated Metal Products	7.130	1377	1.52	87,000	18,500
Electrical & Electronic Equip.	48.103	2078	10.28	356,000	76,000
Motor Vehicles & Equipment	51.496	882	11.0	196,000	42,000
Instruments	8.596	524	1.84	34,000	7,300
Misc. Manufactures	9.700	395	2.08	135,000	29,000
TOTAL	187.5	8921	39	2,052,000	437,800

[1] Derived from data on 1984 imports and net employment changes from trade contained in Kan Young, Ann Lawson, and Jennifer Duncan, Trade Ripples Across U.S. Industries, U.S. Department of Commerce Working Paper, January 1986. Net jobs lost from legal trade are jobs gained from exports minus jobs lost from legal imports. Illegal imports of $39 billion are assumed to be an addition to legal imports, and are distributed in same proportion as industry's share of legal imports.

[2] Based on proportion of illegal imports to legal imports, e.g., for textiles and apparel, (5.04 ÷ 23.64) x 674,000 = 144,000.

TABLE 4

ILLICIT DRUG THREAT TO THE UNITED STATES

SUPPLY (Metric Tons)

	1978	1979	1980	1981	1982	1983	1984	EST. 1985	EST. 1986
eroin	3.7-4.5	3.4-4.0	3.6-4.3	3.9	5.5	6.0	6.0	10.0	12.0
ocaine	19-25	25-31	40-48	40-60	50-75	75-92	110-176	143	150
arijuana	8,800- 11,900	10,000- 13,600	10,200- 15,000	9,600- 13,900	12,300- 14,100	13,100- 15,500	11,400- 16,000	30,000	30,000

REMOVALS (Quantity Seized in Metric Tons)

	1978	1979	1980	1981	1982	1983	1984	EST. 1985	EST. 1986
eroin	.35	.19	.23	.15	.27	.31	.35	.45	(4.5% of Supply)
ocaine	.64	.65	2.2	1.7	5.1	8.9	12.5	22.9	(18% of Supply)
arijuana	2094	1625	1071	2317	1795	1239	1485	1084	(4% of Supply)

Sources: Narcotics Intelligence Estimates for Supply, 1978-1984; Select Committee on Narcotics for 1985-6; DEA for Heroin Removal; Customs for Cocaine and Marijuana Removal.

TABLE 5

NARCOTICS AIR THREAT AND AIR INTERDICTION RESULTS

1984

	Quantity (Lbs)[1]			Aircraft		
	Threat[2]	Seizures	%	Threat[3]	Seizures[1]	%
Marijuana	1,416,585	21,757	1.5%	2361		
Cocaine	46,703	5,083	10.9%	156		
TOTAL	1,463,288	26,840	1.8%	2517	47	1.9%

NOTES:
1. U.S. Customs Data Submitted to Congress in FEB, 1985.
2. Customs Estimate of Total Quantity Entering Continental U.S. by Air.
3. Estimated From U.S. Customs Data on 47 Aircraft Seizures in 1984, and Threat (Quantity) Data in Column 1.

TABLE 6

DRUG AVAILABILITY INDICATORS

	1981	1984
Cocaine		
Retail price per gram	$100-$150	$100-$120
Retail purity	25-30%	35%
Hospital emergencies	3,251	8,510
Deaths	334	617
Heroin		
Retail price per 1.5 grams	$50-$60	$45-$65
Retail purity	3.9%	4.7%
Hospital emergencies	7,037	10,901
Deaths	930	1,046
Marijuana		
Retail price per oz. (Columbian)	$35-$60	$55-$75
Retail price per oz. (Jamaican)	$45-$65	$50-$75
Hospital emergencies	3,031	3,397

TABLE 7

U.S. CUSTOMS SERVICE
Average Positions
by Category
FY 1972 - 1987

Fiscal Year	Inspectors	Import Specialists	Patrol Officers	Special Agents	Total Customs
1972	3,184	1,312	485	853	11,116
1973	3,472	1,304	736	956	11,772
1974	3,693	1,208	971	532	11,878
1975	3,903	1,262	1,152	582	13,076
1976	3,973	1,256	1,191	614	13,380
1977	3,943	1,204	1,365	603	13,229
1978	4,077	1,207	1,251	600	13,854
79	4,174	1,235	1,211	577	14,061
1980	4,165	1,213	1,231	604	13,920
1981	4,379	1,165	1,332	597	13,316
1982	3,987	1,081			12,924
1983	4,122	1,027	1,134	701	12,998
1984	4,289	1,042	1,246	932	13,319
1985	4,262	974	1,236	925	13,042
1986 (C.R.)	4,558	1,014	1,464	949	14,941
1986 (GRH)	4,299	966	1,447	924	13,264
1987 (ADMIN)	3,978	917	1,443	924	12,494
1987 (NTEU)	4,958	1,214	1,464	919	14,641

Source: U.S. Customs Service Budgets

TABLE 8

CARGO PROCESSING WORKLOAD AND STAFF REQUIREMENT

FY 1978-1990

		CARGO PROCESSING STAFF			WORKLOAD				
Fiscal Year	Formal Entries (000)	Cargo Insp.[1] (av. psn.)	Tariff & Trade[2] (av. psn.)	Total Staff (av. psn.)	Entries Per Av. Psn.	Percent Changes (Annual)	Productivity:[3] Entries Processed Per Av. Psn.	Total Cargo Processing Staff Required[4]	Cargo Inspectors Required[5]
1978	4017	4294	4152	8446	476	--			
1979	4384	4398	4170	8568	512	7.6%			
1980	4374	4342	4082	8424	519	1.4%			
1981	4588	4315	3837	8152	563	8.5%			
1982	4703	4002	3748	7750	607	7.8%			
1983	5314	4168	3595	7763	685	12.8%	685	7763	4168
1984	6421	4106	3572	7678	836	22.0%	706	9095	4638
1985	6823	4108	3572	7680	888	5.9%	727	9385	4786
1986	7079	4300	3131	7431	953	7.3%	749	9451	4820
1987	7433						771	9641	4917
1988	7805						794	9830	5013
1989	8195						818	10,018	5109
1990	8605						818	10,220	5365

1. Inspector Positions

2. Import Specialists and Tariff and Trade Support Positions

3. Assumed to Increase 3% From 1983 to 1989.

4. Number of Formal Entries Divided By Entries Capable of Being Processed Per Average Position (Productivity Column).

5. Computed From 1978-1981 Ratio of .51 Inspectors to 1 Cargo Processing Staff.

TABLE 9

INSPECTIONS OF CONTAINERIZED SHIPMENTS

FY 1980-FY 1986

	Containerized Shipments (Millions)	Container Inspections[1]	% Inspected	Fully Unstuffed and Stripped Inspections	%
1980	2.8	192,734	6.8	81,234	2.9
1981	3.1	215,805	7.0		
1982	2.2	186,800	8.5		
1983	2.9	112,843	3.9	21,000	0.9
1984	3.3	93,047	2.8		
1985	4.0	95,000	2.4		
1986	4.8	98,000	2.0		

[1] Mainly Tailgate Exams

Source: U.S. Customs Service

TABLE 10

U.S. CUSTOMS SERVICE FORMAL ENTRIES OF MERCHANDISE AND IMPORT SPECIALIST REQUIREMENT, FISCAL YEARS 1974-1990

Fiscal Year	Number of Formal Entries of Merchandise (000)	Number of Import Specialists	Workload Entries Per Import Specialist	Average Annual Workload Growth[1]	Productivity Per Import Specialist[2]	Required Number of Import Specialists
1974	3,206	1,208	2,650		2,650	1,208
1975	3,015	1,262	2,389	1956-1974		
1976	3,264	1,256	2,600	4.3%		
1977	3,690	1,204	3,065	1974-1986	2,712	1,361
1978	4,017	1,207	3,328	14.7%	2,828	1,420
1979	4,384	1.236	3,547		2,950	1,486
1980	4,374	1,219	3,588		3,077	1,422
1981	4,588	1,165	3,938		3,209	1,430
1982	4,703	1,081	4,397		3,347	1,405
1983	5,314	1,027	5,174*		3,491	1,522
1984	6,421	1,042	6,162*		3,641	1,764
1985	6,823	974	7,005*		3,798	1,796
1986	7,079	966	7,328*		3,961	1,787
1987	7,433	817	9,098*		4,131	1,800
1988	7,805				4,309	1,811
1989	8,195				4,494	1,824
1990	8,605				4,688	1,836

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1. Subcommittee on Trade, Committee on Way and Means, Background Materials on H.R. 9220, July 14, 1976, p. 39, gives Import Specialists workload in FY 1974 and average annual growth of workload, 1956-1974. Workload is measured in number of entries per Import Specialist.

* Bypass instituted by Customs, meaning 55-65 percent of entries are not reviewed by Import Specialists but are processed by clerical personnel.

2. Number of entries each Import Specialist is, on average, capable of processing, assuming 4.3% per annum producivity growth since 1976. The rate of productivity growth is believed to be consistent with recent automation efforts.

3. Number of entries are divided by productivity to obtain required number of Import Specialists.

TABLE 11

FORMAL ENTRIES BY TYPE AND NUMBER REQUIRING IMPORT SPECIALIST REVIEW, FY 1983 AND FY 1986

(In Thousands)

	1983	Percent[1]	EST. 1986	Percent[1]
Total Formal Entries	5314	100	7079	100
Trade Program Entries:				
Quota and Monitored	519.0		1210*	
Licensing Requirements			163*	
GSP	372.4		535*	
Antidumping	24.5		35*	
Countervailing Duty	60.4		99*	
Steel Program	108.8		205*	
Sub-Total	1085	20	2247*	32
Other Agency Entries[2]	1100	20	2056	29
Dutiable Entries[3]	3565	67	6371	90
Estimated Entries Requiring Import Specialist Review[4]	3700	70	5600	79

[1] Components do not add to 100% due to overlap between dutiable entries and other entries.

[2] Entries where Customs enforces requirements of other agencies, e.g., Agriculture, FDA, EPA, etc. Source: U.S. Customs Service.

[3] Dutiable entries were 98 % of total formal entries in FY 85 compared to 67% in FY 80-84. Formal entry definition was changed in FY 85 to exclude entries under $1,000 instead of $250 formerly.

[4] Consists of all trade program and other agency entries, and 20 percent of dutiable entries.

* U.S. Customs data for FY 1985 projected at FY 83-85 growth rate.

TABLE 12

U.S. CUSTOMS REVENUE COLLECTION PER ENTRY

FY 1979-1985

Fiscal Year	Total Revenue Collection ($000)	Revenue From Dutiable Entries[1] ($000)	Formal Merchandise Entries (000)	Formal Dutiable Entries (000)	Average Revenue Collection Per Formal Entry ($)	Average Revenue Per Dutiable Entry ($)
1979	8,460,479	7,585,467	4,384	2,927	1,930	2,592
1980	8,230,100	7,417,512	4,374	2,883	1,882	2,573
1981	9,197,222	8,438,284	4,588	3,014	2,005	2,800
1982	9,981,343	9,189,730	4,703	3,148	2,100	2,919
1983	9,784,959	8,924,129	5,314	3,565	1,841	2,503
1984	12,541,400	11,653,060	6,421	4,042	2,024	2,883
1985	13,237,169	12,288,924	6,823	6,713	1,940	1,831

[1] Sum of Revenue From Consumption Entries and Warehouse Withdrawals.

TABLE 13

REVENUE LOSS FROM 4.3% GRAMM-RUDMAN CUT IN FY 86

Fiscal Year	Amount Of Cut (Millions)	Revenue Loss[1] (Millions)
1986	31	150
1987		450
1988		615
1989		615
1990		615
1991		615
Total Revenue Loss		3,060

[1] From Congressional Budget Office data contained in Senate Budget Committee Report 99-146, October 2, 1985.

Note: Additional cuts imposed in FY 87 or beyond would cause further revenue loss.

STATEMENT OF EUGENE J. MILOSH, PRESIDENT OF THE AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS

Senator ABDNOR. Our next witness will be Eugene J. Milosh, president of the American Association of Exporters and Importers, who will present his testimony.

Mr. MILOSH. Thank you Mr. Chairman, I am very happy to be here.

My name is Gene Milosh. I am president of the American Association of Exporters and Importers [AAEI]. Since the complete statement was submitted and is part of the record, in the cause of brevity, I will summarize our testimony.

Senator ABDNOR. Fine. As you know, your whole statement will be in the record.

Mr. MILOSH. AAEI is comprised of over 1,000 company members engaged in all aspects of international trade, importing and exporting members, shippers, customshouse brokers, freight forwarders, banks and other member service firms interact daily with the U.S. Customs Service, making AAEI one of the closest observers of its operations. We have some three customs committees as well as a committee that meets regularly with Commissioner von Raab and his deputies throughout the year.

Budget cuts mandated by Gramm-Rudman will directly result in the reduction of 770 positions in the Customs Service, further exacerbating the current personnel shortages and delays in processing entries. Less resources and the increasing emphasis on drug interdiction, to the detriment of the commercial side, are factors straining Customs ability to facilitate international trade to the limit.

The proposals in the President's 1987 budget, for imposition of user fees by Customs on a broad range of functions are not a solution to budget deficits and reducing staff.

To impose a user fee for the privilege of paying the customs duties required to be deposited as a condition of entry, of imported merchandise is analogous to charging a taxpayer a fee for filing income tax returns and paying income taxes.

The functions of the Customs Service are required by law, carried out by the government agency for the general welfare and, as such, the cost of this operation should be borne by the general revenue and not by the taxpayers.

The acceptance of entries of goods by Customs in not a desired service, but a requirement from which the taxpayer or the importer received no benefit. It is true that the trade community has consistently asked for increased appropriations and staffing for customs, but user fees are inappropriate when Customs is the second largest revenue producing agency and collects over 20 times the cost of operations in duties.

It has been stated previously that this is good business to have more customs staff. Increased staff means more audits, more concentration on valuation of goods and classification of goods which will bring in more revenues.

I would like to just touch upon one other point regarding user fees. If the Customs Service could implement a system of imposing fees for all or most of its functions, the implementation of such fees would be perceived by our trading partners as an increase in duties and a move toward greater protectionism.

Our exporter members are concerned also that other countries would be encouraged to impose similar fees on U.S. exports. It is also a matter of concern that the user fee charges for imports would be incompatible with the rules of GAAT which requires that fees in connection with imports shall be limited in amounts to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or taxation of imports or exports for fiscal purposes.

The administration's proposal to collect user fees is undeniably for fiscal purposes. In fact, no cost analysis by any government agency has been made. The money collected from the user fees is earmarked for the general treasury, not a special fund to defray the costs for the Customs Service.

In a sense, it would by-pass the congressional appropriations process as well and congressional authority would be abdicated.

Regardless of the intended purposes, the imposition of user fees is simply bad economic and trade policy.

Further, the proposal to impose user fees on imports is not consistant with the objectives of Article VIII of the GAAT, that the contracting parties recognize the need for reducing the number and diversities of fees and charges. In addition, imposition of fees will add to the cost of imports and would be inflationary.

For all the foregoing reasons, AAEI wishes to register the objection of its nationwide membership to the concept of imposing user fees on the functions of a revenue producing agency and urges that these proposals be rejected as a means of reducing the budget deficit. Thank you, Mr. Chairman.

Senator ABDNOR. Well, thank you. The very case that you're making, the points you're bringing out, we have raised at the Finance Committee. I don't know quite what's going to happen, but you do make a good point and we're well aware of it and we thank you for your testimony and bringing it here for us today.

Again, Mr. Milosh, Senator Mattingly, who would have liked to have been here, is now on another piece of work on a committee has some questions, for the record, and I assume you wouldn't mind answering them in writing, would you?

Mr. MILOSH. Not at all, I would be very pleased to.

PREPARED STATEMENT

Senator ABDNOR. Very fine. Thank you very much.

Mr. MILOSH. Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF EUGENE J. MILOSH

Good Afternoon, Chairman Hatfield, members of the Subcommittee. My name is Eugene J. Milosh and I am President of the American Association of Exporters and Importers. The Association is a national organization comprised of approximately 1100 U.S. firms involved in every facet of international trade. Our members are active in importing and exporting a broad range of products including chemicals, machinery, electronics, textiles and apparel, footwear, foodstuffs, automobiles, and wines. Association members are also involved in the service industries which serve the trade community such as customs brokers, freight forwarders, banks, attorneys and insurance carriers. AAEI is the closest observer of the U.S. Customs Service.

We are pleased to have this opportunity to address the U.S. Customs Service budget for Fiscal Year 1987. The funding for Customs' operations is of great concern to the Association, as many of our members deal with U.S. Customs on a day-to-day basis.

The Association and Customs have always dealt with each other in a direct and honest, if not always harmonious, manner. Due to this longstanding relationship, a relationship which is frequently of an adversary nature, the Association does not hesitate to point out problems to or ask questions of Customs. We believe both sides, as well as the public, greatly benefit from this exchange and we are pleased to say that, through discussion, many problems are resolved. This is not to say that we always reach a mutually satisfactory resolution. Indeed on many occasions we do not. We do not know whether Customs is satisfied with its level of staffing. In our opinion, however, the Service's resources are strained to the limit.

The problems faced by our members will be exacerbated dramatically by the cuts in the Customs' Budget for 1987 mandated by Gramm-Rudman. There are already drastic shortages in manpower in Customs ports around the nation. This fact was recognized last year by the Congress when it restored over 750 positions to the 1986 Customs Budget. Customs has said it will meet the requirements of Gramm-Rudman by again eliminating over 750 positions. Programs such as Customs Automation and development of a periodic entry system would help to make the Service more efficient but would only resolve part of the problem. AAEI believes that the Customs Service needs more trained personnel at appropriate levels of responsibility, now; mandated budget cuts would worsen the current shortages and delays caused by the lack of personnel. According to studies by the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) Customs' budget would be reduced $34.4 million over the remainder of fiscal year 1986 (to September 30, 1986) as a result of Gramm-Rudman. Even though the Administration has resisted staffing increases in the past, the increase in Customs resources has directly led to increases in Customs revenue. A reduction in Customs resources has resulted and will continue to result in delays in processing entries and paperwork with a corresponding decrease in the quality of the work performed. Since Customs collects over $20 for each dollar it spends, a reduction in spending and manpower could lead to a decrease in revenue.

The shortage of manpower is complicated by another factor. The primary responsibility of the Customs Service has always been and should continue to be international trade. There is an unfortunate trend to view the Customs Service as a narcotic interdiction agency. While interdiction of narcotics is a worthwhile cause it is not the most efficient or correct use of the Customs Service's human and other resources especially when their commercial resources are strained to the limit. At present staffing and resource levels, Customs cannot be expected to continue as the major drug interdiction agency, the second leading revenue raiser, and at the same time to enforce the regulations of forty-odd other federal agencies. If the Service is expected to continue in each of these roles it must be given the resources to do so.

Moreover, the imposition of user fees on passengers, vessels and commercial entries as proposed by the Administration is not the solution to low levels of staffing or the budget deficit. The Administration expects to raise $582.1 million through the collection of such fees.

The fees are intended to recover the cost of Customs Service operations. The U.S. Customs Service is a tax collection agency which also functions to regulate trade. In its collection capacity, its role is analagous to the role of the Internal Revenue Service in collecting income taxes. To impose a "user fee" for the privilege of paying the customs duties required to be deposited as a condition of entry of imported merchandise is analagous to charging a taxpayer a fee for filing an income tax return and paying income taxes. This is a concept which clearly would offend the tax paying public; it is no less offensive to the importing public. Further, the duties and other fees now collected by the Service exceed its budget by twenty-fold.

The customs clearance of imported merchandise, inspection of goods, assessing duty, and ensuring it is not prohibited from importation by law or regulation, is not a "service" to the importer/taxpayer. It is an obligation of the Customs Service to the public to carry out these functions and to insure that the correct amount of customs duty is deposited, and that no law is violated by importation. These functions are no more a "service" to the importer than is the processing of an income tax return and collection of the income tax payable. In each case, the function is a requirement of the law, carried out by a government agency for the general welfare. As such, the cost of this operation should be borne by the general revenue and not by the taxpayer. In each case, it is not a desired service, but a requirement from which the taxpayer receives no benefit. AAEI agrees with the General Accounting Office which concluded, "GAO does not believe there is merit in assessing user's fees for those formalities that are not voluntary, because these formalities protect the nation as whole." GAO Report OC-9-85-1. An example of a valid user fee is the government's and NASA's requirement that a private U.S. concern pay a fee for the use of the space shuttle, to launch a satellite or in which to perform experiments. The service is optional, requested by the private concern and directly benefits and profits that party, not the U.S. taxpayer.

It is true that the trade community has consistently asked Congress for larger appropriations for Customs. Year after year the workload on Customs personnel increases and year after year they support budget proposals that provide them with fewer resources and personnel, especially in the commercial operations area. However, it should be emphasized that the duties collected by the U.S. Customs Service far exceed the dollar outlay for its collection/inspection functions by a ratio of 20 to 1.

While the Customs Service has charged additional user fees for certain specified services since its inception in 1789, e.g. fees for vessel navigation, bonds for air and vessel passenger carriers, etc., the broad concept of attempting to recover the primary cost of operation of a revenue producing agency is unnecessary, improper, and objectionable.

If the Customs Service were to implement a system of imposing fees for all or most of its functions, the implementation of such fees would be perceived by our trading partners as an increase in duties, and a move toward greater protectionism. Our exporter members are concerned that other countries would be encouraged to impose similar fees on U.S. exports. It is also a matter of concern that the user fee charges for imports would be incompatible with the rules of the General Agreement on Tariffs and Trade, which requires that fees in connection with imports "shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes." The Administration's proposal to collect user fees is undeniably for fiscal purposes. In fact, no cost analysis by any government agency has been made. The money collected from the user fees is earmarked for the general treasury, not a special fund to defray the costs of the customs service. Regardless of the intended purposes, the imposition of user fees is simply bad economic and trade policy.

Further, the proposal to impose user fees on imports is not consistent with the objective of Article VIII(b) of the GATT, that the contracting parties recognize the need for reducing the number and diversity of fees and charges. In addition, imposition of fees will add to the cost of imports, and would be inflationary.

The imposition of such user fees was not recommended by the President's Private Sector Survey on Cost Control, in the Report of the Task Force on User Charges. As pointed out therein by the Grace Commission (at page 196), Customs passenger processing and requirements for the formal and informal entry of merchandise are for the benefit of society as a whole. These functions protect the revenue, deter smuggling and the importation of contraband, and are necessary to enforce the laws. As further observed therein, the formal and informal entry of goods and entry by mail are services that support the general economy and for which a fee -- the duty on goods or postage -- has already been paid. These functions also serve as a protection for domestic industry.

In conclusion, the imposition of user fees on passengers, shippers and commercial entries is unfair, uneconomic, and violates existing international agreements. AAEI is convinced that their implementation will lead to constraint of trade, international retaliation and possible disruption of the normal flow of passengers and cargo.

Together with the budget reduction, and corresponding staffing cuts mandated by Gramm-Rudman, user fees will be the "straw which breaks Customs' back." AAEI urges you to oppose the inclusion of user fees in the 1987 budget and thanks the members of the subcommittee for the opportunity to make its views known.

PREPARED STATEMENT OF THE AIR TRANSPORT ASSOCIATION

Senator ABDNOR. At this point I would like to ask unanimous consent that a statement by the Air Transport Association be placed in the record.

[The statement follows:]

STATEMENT OF THE AIR TRANSPORT ASSOCIATION OF AMERICA

The Air Transport Association of America, which represents most of the scheduled airlines of the United States, appreciates this opportunity to make the following two observations with respect to the fiscal year 1987 appropriations for the U.S. Customs Service.

SINGLE CUSTOMS SHIFT AT AIRPORTS

The U.S. Customs Service has postponed, at least until October 1, 1986, its proposed reduction of tours of duty at U.S. airports to a single, standard shift from 8 a.m. to 5 p.m. If this proposal does go forward on October 1, clearance of aircraft, inspection of crew and passengers and their baggage, and processing of cargo and courier shipments will be crowded into one 9 hour period of time at U.S. gateway airports. The United States, in effect, will be closed down by Customs outside of these hours unless it agrees to pay its inspectors overtime to reopen the United States.

This makes no sense operationally or economically, and would inevitably result in serious international problems for our Government and our flag carriers, including, at a minimum, very damaging retaliatory measures by other nations. We, therefore, respectfully request the subcommittee to direct the Customs Service to take no action to implement this proposal, or any other, which will reduce the hours or levels of service currently provided by Customs at U.S. airports of entry.

In terms of its impact within this country, the Customs proposal should be permanently abandoned because:

Long hours of inspector overtime will be required, reducing the efficiency and quality of the inspection process;

Customs will require millions of dollars in additional appropriations to fund these overtime costs, and the $25,000 overtime cap on inspectors will have to be waived;

Most peak 9 hour periods at major gateway airports do not coincide with the arbitrary 8 a.m. to 5 p.m. standard shift; and

Crowding Customs inspectors at airports into a single arbitrary shift will result in a waste of manpower and in operating inefficiencies, even though some inspectors may be redeployed to other locations for other duties.

REVOLVING FUND FOR CUSTOMS USER FEES

We understand that consideration is being given to an additional set of user fees which would raise over $300 million in revenues, covering commercial import transactions. As we have stated on many occasions in the past, we believe that such an imposition is inappropriate. However, should the Congress ultimately conclude that such fees are both necessary and consistent with GATT provisions—including all understandings that certain entries are to be free of such nontariff barriers—we urge that explicit provision be made for the addition of the fee to the direct waybill rather than any master document, to ensure payment by the consignee, similar to the mandated entry on passenger tickets in the case of the existing fees.

In total, it is contemplated that cargo, passenger, and sundry other fees would raise some $582 million in the first full year of implementation. Although the airlines have always opposed user fees on sound public policy grounds, we feel it is imperative that, if a schedule of fees is adopted, the revenues collected be expended for the purpose collected. This can be done by establishing a revolving fund to which fees would be remitted for expenditure by the Customs Service to augment its resources, and not to the general Treasury fund. Moreover, in order to prevent the buildup of an unexpended, uncommitted surplus, such as the unconscionable status of the aviation trust fund, provision should be made for a zero-balancing of the Customs fund every 2 or 3 years, entailing reduction or elimination of the fees until the surplus has been exhausted. To do otherwise is to make a mockery of the appelation user fees.

CONCLUSION

The House subcommittee was instrumental in directing Customs to withdraw its announced plan to reduce hours of service at U.S. gateway airports to a single shift. The airlines are most appreciative of the action taken and commend the chairman and the subcommittee for it. We now urge that the single shift proposal be scrapped permanently by the Customs Service at the direction of the House and Senate subcommittees.

We also solicit the support of the subcommittee in establishing a zero-balancing revolving fund through which all user fees collected would be remitted directly to the Customs Service. Customs would in turn be obliged to provide adequate resources and staffing at airports, including at satellite airport terminals, to meet international traffic demands.

Continuing multishift schedules at airports and adoption of a revolving fund concept for any users fees which are imposed, plus streamlining and modernizing Customs formalities will help to posture Customs for its proper role in the closing years of the 20th centruy, benefiting international air shippers and travelers alike. The alternative, as envisioned by the fortunately aborted single shift proposal, is a regression to the role contemplated for Customs by its now anachronistic 1911 statutory charter, adequate at best for an era of transportation by steamships.

PREPARED STATEMENT OF SENATOR PAUL LAXALT

Senator ABDNOR. Also, at this point I would like to ask for unanimous consent that a statement of Senator Laxalt and accompanying statements of James D. Santini and James V. Taranik, dealing with the national defense stockpile transaction fund appropriation to the Mackay School of Mines located at the University of Nevada in Reno, be placed in the record.

[The statement follows:]

STATEMENT OF SENATOR PAUL LAXALT

Last year, this committee agreed to add $10 million to the National Defense Stockpile Transaction Fund appropriation for the Mackay School of Mines located at the University of Nevada, Reno, to initiate a strategic materials program. I thank the members of the Committee for their willingness to accept my amendment to add that money, and I particularly thank the Chairman, my good friend from South Dakota, for his efforts to protect the funds in conference with the House. Also, I thank the outstanding staff of the Committee, Chuck Parkinson, and Dorothy Pastis, from the majority, and Bobby Mills, from the minority, for handling all the details required to make this grant a reality. On behalf of the University of Nevada, Reno, I want you all to know I appreciate your efforts.

Mr. Chairman, I am pleased to report to the Committee that the University has commenced work on the new program. The federal monies will be used to complete Phase II of the New Mines Building, relocate the Generic Center on Waste Treatment and Secondary Strategic Materials Recovery and to establish the Policy Center on Strategic Materials. Already the University has received $480,000 from the Administrator of the General Services Administration and awarded the contract for the architectural and engineering work. If the current schedule holds, construction will start before the end of the fiscal year.

This impressive schedule will be met due to the close working relationship that already exists between the GSA, the University, and the State. All parties acknowledge the need for a federal strategic materials research program and are dedicated to getting it off the ground as soon as possible. The University has committed to do everything it can to manage the program efficiently and to contribute its own resources to the program.

As you know, Mr. Chairman, my amendment originally requested $15 million for the program. In conference with the House, that amount was reduced to $10 million, but with a committment that "the Conferees will consider providing in FY 1987 the balance required to complete construction" (House Report 99-349). I request that when you consider the FY 1987 Treasury, Postal Service and General Government Appropriations bill you add the $5 million needed to complete the project. The full $15 million is needed to make the program the success Congress intended. Without the remaining $5 million the School of Mines will not be able to purchase all the equipment it needs to do the supporting research. With the project underway and with the support of all the parties, I believe now is the time to guarantee the program's success by providing the remaining funds. If the Committee does so, I can assure you, you will be pleased by the final product.

STATEMENT OF JAMES D. SANTINI

I appreciate the opportunity to express my support for a $5 million grant to the Mackay School of Mines located at the University of Nevada, Reno to complete funding for a strategic materials program. This grant, along with $10 million appropriated for the same project in the Fiscal Year 1986 budget, will enable the Mackay School to open the most comprehensive, state-of-the-art strategic material research and policy development center in the world. Significant benefits will flow from this center both to the state of Nevada and to the nation.

As former Chairman of the House Mines and Mining Subcommittee and as a member of the Natural Strategic Materials and Minerals Program Advisory Committee, I am keenly aware of the need for the United States to have strategic materials policies designed to protect our vital national interests under any circumstances. As the world beyond our borders becomes more unstable, we need to work to guarantee supplies of strategic materials found overseas, or through research, to develop alternatives. The new strategic materials program at the Mackay School of Mines will accomplish both these goals. In addition, the Mackay School would become a national repository for research and explanation files of major mineral firms that no longer have a use for such information. This information would be stored, cataloged and computerized in order to enhance the federal mining date bases. In this manner, critical mining information will be preserved for future generations.

As a nation, we have long needed a strategic materials program. I am pleased to see the Committee move ahead on this project.

I am equally pleased to see this center established at the Mackay School of Mines. I am presently serving on the Mackay School of Mines Advisory Board, and I am well aware of the outstanding reputation of the School and of all its accomplishments. Established as a separate school within the University of Nevada in 1988, the School manages the Nevada Bureau of Mines and Geology and runs the Mackay Mining Museum. In 1981, the School was chosen as one of 31 Mineral Institutes by the U.S. Bureau of Mines. In 1983 it was designated one of the six Generic Research Centers for mineral waste treatment and secondary strategic materials recovery by the Department of the Interior. Finally, the School is conducting ongoing research for the National Aeronautics and Space Administration and the National Oceanic and Atmospheric Administration. In all these efforts, the Mackay School has been a leading institution.

The School also generates significant economic activity for the state. Nevada is a major producer of strategic materials in the United States. The School provides many of the geoscientists and engineers needed to fully develop Nevada's mineral potential. I am confident that the benefits to the State will only increase if the Mackay School becomes a strategic mineral policy center.

Mr. Chairman, in response to the clearly demonstrated need last year, your Committee appropriated $10 million to initiate the program. I appreciate your consideration of that request. However, another $5 million is needed to complete the task and to make the new policy center first rate. I urge you to appropriate the remaining monies in the Fiscal Year 1987 budget. With the full $15 million, the Strategic Mineral Policy Center will serve a pivotal role in developing future national strategic mineral policies.

STATEMENT OF JAMES V. TARANIK, DEAN OF MINES, UNIVERSITY OF NEVADA, RENO

On December 14, 1985 President Reagan signed an appropriations bill that provided $10,000,000 to the Mackay School of Mines to initiate a strategic materials program at the University of Nevada-Reno. This appropriation has allowed the University of Nevada System to move rapidly ahead to address critical national needs for research and information related to the national strategic materials problem. The University System and the State of Nevada are most thankful for this favorable the consideration by the United States Government and offer this progress report for the consideration of Congress.

The Mackay School of Mines

In response to the National Land Grant Act of 1862, the Nevada Constitutional Convention of 1864 established requirements for instruction in Agriculture, Mechanic Arts and Mining. Nevada was unique in adding the words, "and Mining," but the addition was appropriate because of the major discovery of precious metals in the Comstock Lode in Virginia City. Although formal instruction in mining and assaying began in 1874, it was not until 1888 that a "School of Mining" was established in the University of Nevada. Today, the Mackay School of Mines ranks as one of the foremost professional schools in the country for instruction and research in mineral engineering and the geosciences. Academic programs of study managed by the School consist of the departments of Chemical and Metallurgical Engineering, Geological Sciences (including the geology, geochemistry, geophysics, geological engineering and hydrology/hydrogeology degree programs) and Mining Engineering. In addition, the School manages the Nevada Bureau of Mines and Geology---Nevada's geological survey, and the State Seismological Laboratory. Other important public service divisions of the School include the Mines Library and the Mackay Mining Museum. Major research facilities of Mackay School of Mines include the Commonwealth Mine Training Center, the Center for Aerospace Science and Terrestrial Applications, and the Center for Neotectonics Research.

In 1981 the U. S. Bureau of Mines selected Mackay as one of 31 Mineral Institutes and in 1983 Mackay was also designated as a "Generic Research Center for Mineral Waste Treatment and Secondary Strategic Materials

Recovery"---one of six in the country. The Mackay Mineral Resources Research Institute and its Generic Center work closely with the Reno Research Center of the U. S. Bureau of Mines. The Reno Research Center is located adjacent to the main physical plant of the University of Nevada-Reno and is extensively engaged in strategic materials research. Several of the Reno Research Center government staff serve as adjunct faculty at the Mackay School of Mines.

Mackay School of Mines was selected by the National Aeronautics and Space Administration to conduct research in the application of state-of-the technology aerospace methods to global exploration for mineral resources. Current research in aerospace remote sensing includes the Shuttle Imaging Radar, Airborne Imaging Spectrometer, Landsat Thematic Mapper and Thermal Infrared Multispectral Scanner research programs. In addition, faculty within the School are participating in science and engineering definition studies for the Manned Space Platform and the Polar Orbiting Platforms. The National Oceanic and Atmospheric Administration has recently completed a memorandum of understanding establishing a joint institute for aerospace science and terrestrial applications at Mackay School of Mines. The Institute will conduct joint research with the Government to prepare the geoscience and mineral engineering community for global space platform data in the decade of the 1990's. The joint Institute for Aerospace Science and Terrestrial Applications is a key element in the development of new technologies that will assist global assessment and exploration for strategic materials needed by the national economy.

Nevada is the major producer of important strategic materials in the United States. A 1985 report by the U. S. Bureau of Mines lists 37 principal strategic and critical mineral deposits as occurring in the State of Nevada. Of those listed, 17 strategic and critical minerals occur in deposits that can be economically mined. There are over 300 operating mines in the State of Nevada and 39 of these mines report an expanding strategic mineral reserves base of over $20 billion. Currently, over 100 major mineral and energy firms are located in Nevada. The State ranks number one in the production of precious metals and mercury and it is a major producer of barite, fluorspar, lithium, magnesite, and tungsten.

In recognition of the national importance of the Mackay School of Mines, the major research programs underway at the School and the importance of the minerals and energy industry in the State, the Nevada Legislature provided $6.7 million for a New Mines building constructed in 1983, and $1.4 million for new equipment in that building in 1985. The University of Nevada Foundation raised an additional $3 million from private gifts for state-of-the-technology equipment in the new building.

The Federal Strategic Materials Grant for Fiscal Year 1986

In recognition of these national and state commitments to higher education in mineral engineering and geological sciences at the Mackay School of Mines, Congress appropriated, and the President signed into law, provisions for a Fiscal Year 1986 Federal Grant of $10 million to the Mackay School of Mines, University of Nevada Reno. That Grant was made to complete Phase II of the New Mines Building, relocate the Generic Center on Waste Treatment and Secondary Strategic Materials Recovery and to establish the Policy Center on Strategic Materials, including such equipment as the School deems necessary in the conduct of its activities. Congressional language pertaining to the Grant stipulates that $10 million is to remain available, until expended, for these projects. The Congressional Conference Report also instructs the institutions participating in this program to return in Fiscal Year 1987 to secure the balance of requested funding under the Strategic Materials Program.

On January 9, 1986 the University of Nevada System Board of Regents accepted the Federal Grant and passed provisions to allow the project to move expeditiously to a top priority in the State Capital Improvements Budget. On January 22, 1986 the Interim Finance Committee of the Nevada Legislature met and approved acceptance of the Federal Grant which will be managed as State of Nevada Project Number A-86-1. The Nevada Public Works Board met on January 29, 1986 and approved the solicitation for proposals for Architects and Engineers. On February 18, 1986, the President of the University and the Dean of the Mackay School of Mines received the first $480,000 in funds for the project from the Administrator of the General Services Administration. On March 21, 1986 the firm of Casazza, Peetz and

Associates was selected by the Nevada Public Works Board as the Architectural and Engineering firm for the project, (Attachment 1).

At the recommendation of the Public Works Board, construction of the 79,000 square foot new wing has been separated into two stages, (Attachment 2). The first stage of the project is now underway and involves development of a schematic design for the total project, the demolition of the Veternary Science Building, relocation of major electrical, water and steam utilities, excavation for the foundation structure, completion of major footings and retaining walls to grade, development of bidding documents for the first phase of construction and construction services for project stage 1. The bidding documents for Stage I are to be completed not later than July 15, 1986. A Stage I contractor will be selected by August 15, 1986 and Stage I construction should be complete by November 15, 1986, (Attachment 3). The Architectural and Engineering firm is providing Stage II services including design development for Stage II, construction documents for the balance of the project, bidding documents for the completion of the project and construction phase services, (Attachment 4). The Design/Development for Stage II will be completed in August 1986. The Construction Documents for Stage II will be completed by November 1986 and selection for the construction of Stage II will occur in February 1987. The construction of Stage II will be completed by December 31, 1987, (Attachment 3). Phase II of the New Mines Building will be occupied in the spring of 1988---the 100-year anniversary of the establishment of a School of Mining in the State of Nevada.

The Policy Center on Strategic Materials

Ammendment Number 68 of House of Representatives Conference Report 99-349 establishes the Policy Center on Strategic Materials at the Mackay School of Mines, University of Nevada-Reno. In response to a 1985 Office of Technology Assessment Report entitled, "Strategic Materials: Technologies to Reduce U. S. Import Vulnerability," Mackay School of Mines submitted a proposal for a $15 million Federal grant to establish a strategic materials program that would address national needs. Nevada Senator Paul Laxalt introduced an ammendment to HR 3036 to provide for such funding and his ammendment was approved by the United States Senate on September 26, 1985. When the House-Senate Conference Committee met on October 30, 1985 the Committee agreed to reduce the request in Fiscal Year 1986 to $10 million. Conference Committee Report 99-349 instructs, "This amendment appropriates $10,000,000 for a grant to construct and relocate a research facility. The Conferees recognize the importance of these facilities, but in this time of budget constraint only partial federal funding was provided this year for both projects included in ammendments numbered 67 and 68. In addition to the cost sharing programs developed by the institutions involved, the Conferees will consider providing in FY 1987 the balance required to complete construction."

In September 1985 Mackay School of Mines submitted a proposal entitled, "Development of the Mackay School of Mines as a National Center of Excellence in Strategic Materials Education, Research and Policy Development." That proposal identified a a need to refurbish the existing 1908 Mackay School of Mines building so the facility would meet modern earthquake standards, (Attachment 5). That proposal also identified the need for new construction to provide facilities for the Mackay School of Mines Library now in temporary space, and for the Policy Center on Strategic Materials. To complete the project the proposal identified a need for $5 million in federal funding and $2 million in non-federal funding. The Mackay School of Mines Renovation Project was approved by the University of Nevada System Board of Regents and was assigned to the Official UNS Capital Improvements Project list on January 9, 1986.

Since the $10 million federal grant was awarded to establish a Strategic Materials Program at Mackay School of Mines the School has had discussions with officials in the U. S. Bureau of Mines and the minerals industry regarding the national need for the Policy Center on Strategic Materials. These discussions have culminated in proposals submitted to the Society of Economic Geologists and to mineral companies that are no longer functional, (Attachment 6). A major role of the Policy Center on Strategic Materials and the International Center on Economic Geology would be to act as a national repository for the final disposition of research and exploration files of major mineral firms that no longer have a need for such information. Four major firms have contacted the School in this regard, but the most serious offer to date has come from the Anaconda Company. The Anaconda Company will cease operations in summer of 1986. The records of the Company consists of 200 file cabinets of maps and comprehensive reports on mineral occurrences throughout the world. Many of the files and reports deal with areas that are no longer accessible to the United States Government. Mackay School of Mines' proposal is to provide the historic preservation, archiving and library facilities for this collection to include a computerized data base that would be linked to federal data bases. The provision for facilites for the Policy Center on Strategic Materials is a key element in preserving mineral industry records for future generations of Americans.

Mackay School of Mines requested $4.5 million in new equipment for the Phase II addition to the New Mines Building as a match to the federal strategic materials grants, (Attachment 7). In addition, the University of Nevada-Reno has requested State Capital Improvements funds to replace the Veternary Medicine and Physical Plant buildings that will be displaced by the Strategic Materials Projects. The estimated costs to the State of Nevada for relocation of these facilities are $2.2 million and $1.4 million respectively. The University of Nevada Foundation has a $2 million fund-raising project underway for the Mackay School of Mines Library and the Mining Museum. The $4.5 million equipment request, the $3.8 million for relocated buildings and the $2 million for restoration more than provide a cost-sharing match to Mackay's request for the balance of federal funding in Fiscal Year 1987.

(The attachments are being retained in the subcommittee files.)

ADDITIONAL PREPARED STATEMENTS

Senator ABDNOR. This concludes the oral presentation today. I certainly would like to thank all of our witnesses for appearing and your testimony is going to be helpful as we proceed to mark up the fiscal year 1987 Treasury bill which is going to be quite a challenge for this committee under the circumstances that we have to work with.

A number of organizations have requested that their statements be made a part of this record, so I am going to ask unanimous consent that the record remain open for 2 weeks until April 30, 1986 for the inclusion of such material.

[The statements follow:]

LETTER FROM M. TERESA BUTLER, CHARGE D'AFFAIRES, EMBASSY OF THE COMMONWEALTH OF THE BAHAMAS

21 April, 1986

Senator James Abnor
Chairman
Subcommittee Treasury, Postal
Service and General Government
SD-188 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Mr. Chairman:

On the 16 April, 1986 your Subcommittee on Treasury, Postal Service and General Government held public hearings to evaluate the efforts of the Gramm-Rudman-Hollings Budget Reductions on various programmes pertinent to the Subcommittees responsibilities.

Among those matters addressed was the budgetary reductions to the U.S. Customs Service drug interdiction programmes.

For some time The Bahamas Government has cooperated with U.S. Law Enforcement Agencies in an attempt to supress the illegal flow of narcotic drugs through the Bahamian archipelago. An integral part of the joint U.S.-Bahamian campaign against the illegal traffic is the AEROSTAT balloon system.

Presently the U.S. Customs Service has one AEROSTAT stationed in the Northern Bahamas at Grand Bahama Island. The success of the improved surveillance capability in the Northern Bahamas has served to highlight the critical need for a complimentary system in the Southern Bahamas if we are to stop the flow of drugs through The Bahamas and into the United States.

The Bahamas' commitment to the AEROSTAT programme is outlined in the attached statement. We urge that your subcommittee resist any budgetary cuts which could jeopardize the future of the programme.

I respectfully request that the attached statement be included as a part of the hearing record for the 16 April, 1986 hearings before your subcommittee.

Sincerely

M. Teresa Butler
Charge d'Affaires a.i.

REVIEW OF JOINT U.S. - BAHAMAIAN COOPERATIVE EFFORTS IN THE WAR AGAINST THE TRAFFIC OF ILLEGAL NARCOTIC DRUGS

THE BAHAMAS' GEOGRAPHICAL POSITION, LYING OFF THE SOUTHEASTERN COAST

OF THE NORTH AMERICAN CONTINENT, MAKES IT VULNERABLE TO ACCESS AS

A PIPELINE FOR THE DRUG TRAFFICKING TRADE. ITS "TRANSIT STATE" STATUS CALLS FOR CONSIDERABLE FUNDS TO PREVENT THE PASSAGE OF DRUGS THROUGH ITS LAND, SEA AND AIRSPACE. TO PROPERLY PERFORM THIS TASK REQUIRES LAW ENFORCEMENT AGENCIES WHICH CAN OPERATE IN ALL THREE ENVIRONMENTS. THE ENORMITY OF THIS TASK MAY BE APPRECIATED WHEN ONE RECOGNIZES THAT THE BAHAMAS IS AN ARCHIPELARGIC STATE COMPRISED OF SOME 700 ISLANDS SCATTERED OVER AN AREA OF 100,000 SQUARE MILES OF SEA. THE BAHAMAS HAS A TOTAL ESTIMATED POPULATION OF 240,000 PEOPLE. AS A RESULT THE VAST MAJORITY OF THE ISLANDS HAVE NO PERMANENT YEAR ROUND POPULATION.

For years the Bahamian Defence Force officials have faced the seemingly insurmountable task of patrolling the marine areas to curb the three-pronged threat of illigal fishing, drug smuggling and illegal immigration.

Prior to The Bahamas gaining independence in 1973 the onus of patrol fell upon the British. A British frigate patrolled the areas and some military aircraft were based in Nassau. Although the frigates have good communication equipment, this type of vessel was not designed for patrol in The Bahamas where the sea bank's average depth of water is about ten feet. In addition the archipelagic nature of the territory was a disadvantage for the Royal Navy Frigates.

By mid-1970's the Marine Division of the Police was expanded and the Royal Bahamas Defence Force (RBDF) was created to operate the four MK 60 feet patrol boats previously owned by the Police and thirteen other crafts ranging in size from twenty-nine feet to one-hundred and fifty feet.

The quickest and most efficient way to patrol an area is by aircraft. In 1981 the Government formed the Defence Force Airwing and leased an aero-commander from Bahamasair, the national air carrier. This aircraft has given good service although it was not built for military purposes.

TRAINING

The numerical strength of the Royal Bahamas Defence Force stands as of February 1986 at 50 officers and four-hundred and eighty marines. Officers have been trained at the Royal Navy College, Dartmouth, England. All seamanship and advancement training is undertaken at Coral Harbour, New Providence, Bahamas where the Defence Force base is located.

The Government of The Bahamas acknowledges its deep gratitude and appreciation for the technical training which has been afforded some of the staff from The Bahamas Defence Force by United States agencies in recent times.

During 1985, twenty-three RBDF personnel (Able-Seaman to Lieutenant) benefitted from thirteen courses offered by the U.S. Government.

To date twenty RBDF personnel have been nominated to attend twelve courses during 1986 and there are five more nominations to be submitted when the dates of the courses in the fall of 1986 are known.

Mention must be made of the courses conducted under the International Military Education and Training Programs which were attended by radio technicians, electricians and mechanics. As a direct benefit of these studies, the Defence Force attributed the ability of its ship to make longer voyages as defects could now be attended to at sea instead of making the time-wasting trips to the base on New Providence for repairs.

At Governor's Island, New York our personnel were taught the essentials of search and rescue operations to aid them in approaching other vessels at sea.

As far as drug interdictions are concerned, the seamen received invaluable exposure as exchange personnel on board U.S. Coast Guard boats and were able to study methods of interdicting persons engaged in drug trade.

Undoubtedly, this exposure has had the cumulative effect of instilling the much-needed confidence in the seamen in their confrontations with drug traffickers during their assignments at sea. These bilateral arrangements between the U.S. and The Bahamas are important examples of the strides which can be made towards the eradication of the common enemy of the drug trade which is being faced by both our countries in this period of our history. Our combined efforts can further carry the message to drug dealers that their activities in these parts will be closely monitored, and that swift action will be taken on our part to bring them to justice.

OPERATIONS

The drug smugglers have numerous routes and methods of operation. The Defence Force deploys its craft in areas where they have intelligence reports that smugglers will use, but on numerous occasions have been foiled in their attempts to make arrest as smugglers have used decoys to camoflage their presence elsewhere in the cays and island chain. The Defence Force has found that smugglers are well organized and are well-equipped with an abundance of funds and possess good communication and intelligence gathering networks.

The Defence Force, which is a relatively young agency collaborates closely with other Bahamian law enforcement agencies, namely Customs, Police, Immigration and the Department of Fisheries. It also works closely with the U.S. Coast Guard with whom it presently enjoys excellent relations. The experience and expertise of the officers and marines develop daily as they undertake patrol duties. Although some impact has been made on the drug operation, the sophistication of the drug smugglers have been noticed in their modus operandi as is evidenced by the change of primary means of transportation from sea to air.

In April 1985, drug interdiction in the South Florida/Bahamas area took a giant leap forward with the first joint U.S.-Bahamian enforcement operation. Initially dubbed "Blue Lightning" the Operation originated in a February meeting between Vice-President George Bush and Bahamian Minister of National Security, A. Loftus Roker, and Foreign Affairs Minister, Clement T. Maynard. Coordinated by the National Narcotics Border Interdiction System, Blue Lightning netted 62000 pounds of marijuana and over 6300 pounds cocaine. The operation also established the groundwork for continued joint U.S.-Bahamian operations on a day-to-day basis.

Since April 1985 the U.S. and The Bahamas have quietly worked together to seize over 217,000 pounds of marijuana and nearly four metric tons of cocaine. The efforts have also resulted in the seizure of forty-seven vessels, eight aircrafts and six vehicles. Over 150 persons have been arrested.

The islands targeted in the "Blue Lightning" exercise were Exuma, Andros and Bimini. During the raids, U.S. Coast Guard vessels surrounded the islands while Bahamian forces boarded and searched the vessels. Drug Enforcement Agents and police carried out simultaneous searches in villages and remote island areas.

The effort required the combined forces of twenty-six agencies of both governments: over eighty-five law enforcement vessels: over thirty aircrafts: a half-dozen radar facilities and a total of more than 775 people.

On August 15, 1985 a similar type of operation called "Operation Thunderstorm" was initiated and was continued to September 8, 1985.

A command post was set up at the U.S. Embassy's Drug Enforcement Agency. This command post was manned twenty-four hours continuously by the D.E.A., the Royal Bahamas Defence Force and the Police. As this was the second operation of its magnitude with U.S. involvement, all went quite smoothly and intelligence information was exchanged between the agencies. Seizures from the operation amounted to 87,200 pounds of marijuana, 750 kilos of cocaine, and 36 persons were arrested.

SERVEILLANCE EQUIPMENT - AEROSTAT BALLOON

In February of this year the Ministry of National Security issued a press statement on the success of the interdiction of the flow of dangerous drugs through the Commonwealth of The Bahamas as a direct result of the cooperative efforts of The Bahamas law enforcement agencies and the U.S. Drug Enforcement Administration.

The existence of the surveillance equipment in the northern Bahamas provides a screen for ships passing through that area and has proven to be a vital deterrent. What is required to block the entrance through The Bahamas to United States ports is another device in the southern Bahamas to curtail traffic coming from the south where countries are known to be exporting drugs. Moreover, because of the installation of the Aerostat in the northern Bahamas, drug traffickers have now shifted their routes to the southern Bahamas.

In order to cope more effectively, The Bahamas Government has decided to increase The Bahamas Police Strike Force capability in manpower, and transportation and communication equipment. The Bahamas government has reached an agreement with the U.S. Government for it to assist by providing air transportation (fixed wing aircrafts and helicopters) as well as some communication equipment to The Bahamas. A study team composed of Bahamaian and U.S. officials toured the southern Bahamas and identified a site on Exuma Island adjacent to the airport for the helicopter operations known as Operation Bat.

CONCLUSION

The Bahamas is fully committed to combating the scorge of the illicit drug trade within and outside its borders. It is cognizant of the ruinous effects on the populations of both of our countries. The policy of the Ministry of National Security in this regard is to spare no effort to accelerate its capability for the apprehension of the surveyors of this illicit trade.

The Government of The Bahamas supports the efforts of the Drug Enforcement Administration in cutting off the flow of drugs to the southern United States and with its fullest cooperation to the continuing joint exercises, and for the exchange of intelligence information and personnel.

The size and sophistication of the drug operation requires that a united front be mounted in the war on drugs. We pledge the cooperation of Bahamian Law Enforcement Agencies towards this end, and look forward to receiving the further support of our neighbours in the United States of America.

Letter From James Gashel, Director of Governmental Affairs, National Federation of the Blind

April 18, 1986

The Honorable James Abdnor, Chairman
Subcommittee on Treasury, Postal Service,
and General Government
Committee on Appropriations
United States Senate
SD 188 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Transmitted herewith are copies of testimony for filing in the hearing record for the 1987 Treasury, Postal Service, and General Government appropriations bill.

As you will see by the testimony, we are concerned with appropriations matters relating to two agencies that fall within your Subcommittee's jurisdiction--the United States Postal Service, and the Committee for Purchase From the Blind and Other Severely Handicapped. With respect to the former, we are requesting full funding of $833 million to provide free and reduced rate mail services that are paid for in part by the revenue forgone appropriation. With respect to the latter agency (the Committee for Purchase From the Blind and Other Severely Handicapped), we are asking your Subcommittee to include specific statutory language designed to improve hiring practices of the Central Nonprofit Agencies that are designated by the Committee, as well as to provide Congress and the public greater access to information about employment opportunities and pay for blind and severely handicapped people who work in sheltered workshops.

Thank you for considering these matters. I look forward to working with you and the Subcommittee's staff as the 1987 Treasury, Postal Service, and General Government appropriations bill is developed.

Sincerely,

James Gashel

James Gashel
Director of Governmental Affairs

STATEMENT OF JAMES GASHEL

Mr. Chairman, my name is James Gashel. I am appearing in this hearing on behalf of the National Federation of the Blind. My address is 1800 Johnson Street, Baltimore, Maryland 21230; telephone: (301) 659-9314. I appreciate very much the opportunity you have extended to me to appear before the Subcommittee today.

In the National Federation of the Blind, we represent the blind consumer. We are the blind, more than 50,000 strong. There are state affiliates of the National Federation of the Blind in all states and the District of Columbia. We also have local chapters in most sizeable population areas in the United States. Thus, wherever you go in this country, the blind (through the National Federation of the Blind) have an active, collective voice.

With that bit of background, Mr. Chairman, I will now turn directly to a discussion of the principle concerns we have relating to the 1987 Treasury, Postal Service, and General Government Appropriations bill. First, I will urge that appropriations be continued to the United States Postal Service to cover "revenue forgone" on free and reduced rate mail service. Following those remarks, the balance of my statement will address issues pertaining to the program of employment for blind and handicapped persons in sheltered workshops conducted by the Committee for Purchase From the Blind and Other Severely Handicapped.

Postal Service Appropriations for Revenue Forgone

The revenue forgone appropriation to the United States Postal Service (USPS) continues to be a vital concern to many nonprofit organizations, including the National Federation of the Blind. The current appropriation (post Gramm-Rudman cuts) is $716 million. For the National Federation of the Blind, this translates into a third class nonprofit required five digit presort postage rate of 8.5 cents per piece. Less than a year and a half ago the same rate was 5.2 cents per piece.

Now, we are not just talking about pennies when we talk about these increases in postage rates. The postage bill we will pay this year (calendar year 1986) will be approximately $400,000.00 higher than it was for the National Federation of the Blind to mail the same amount of material to the public during calendar year 1984. That means that about $400,000.00 less will be devoted to our direct service programs conducted to help the blind. Instead, we will be paying that amount and more to USPS this year. These drastic increases in our postage costs could be moderated somewhat if Congress provides full funding of $833 million for revenue forgone during fiscal year 1987.

Under the Postal Reorganization Act (as recently amended by the Consolidated Ominbus Budget Reconciliation Act of 1985), all preferred-rate mailers must now pay the full, attributable costs of their mailings. The rate is supposed to be step 16 on the phasing schedule. However, the rate we are actually paying is above the published rate for step 16. It is currently a matter of legal contention whether the Postal Service has the authority to charge preferred-rate mailers any amount above the step 16 postage rate. However, until the courts decide the question (or Congress provides adequate appropriations) we're being forced to pay the higher amount. In the case of the National Federation of the Blind (if we were required to pay the step 16 rate and no higher), our postage bill for this year would be reduced by about $140,000.00. That's how much the excess charge is costing us this year due to a shortfall in appropriations. So for next year, we are urging Congress to appropriate the full amount in order that our postage rate may be held to step 16 and no higher. The fact sheet I have attached to this statement describes in more detail how essential it is for organizations such as ours that help the blind to continue to have access to a subsidized postage rate. I hope you will consider these facts and my other comments as you address the question of the appropriations amount for revenue forgone. Full funding is truly essential.

Committee for Purchase From the Blind and Other Severely Handicapped

The Committee for Purchase From the Blind and Other Severely Handicapped is requesting an appropriation of $779,000.00 for fiscal year 1987. The Committee's responsibilities are to support and administer a program of employment opportunities for the blind and other severely handicapped in sheltered workshops. Under the Committee's program, goods and services valued at just under $300 million this year alone will be provided to the Federal government. The workforce organized to produce these products and services for the government is composed of approximately 15,000 blind and other severely handicapped employees.

In general, Mr. Chairman, we are concerned that the blind and other severely handicapped workers under the Committee's program do not receive a fair share of the proceeds derived from their labors. Here is an example to make my point. The figures I have come from recent annual operating reports of the sheltered workshop operated by the State of Connecticut Board of Education and Services for the Blind. This is not an isolated example, it is typical. The information shows that blind direct labor workers at the Connecticut workshop average $1.86 per hour, while sighted direct labor workers average $4.20 per hour. Ninety-three percent of the direct labor workers are blind, handicapped, or blind and handicapped. The average pay for these individuals is $2.04 per hour.

Now as far as management and supervision are concerned, only 35% of the employees in that category are blind or handicapped. Twenty out of 31 are sighted without handicaps. The pay for these 20 individuals averages $8.25 per hour as compared to pay for blind managers (including those with handicaps) which averages $5.54. In the workshop's workforce as a whole, 79% of all employees are blind or handicapped. But these individuals only receive 36% of the pay. On the other side of the ledger, the sighted who are not handicapped represent only 22.41% of the workforce, but they receive almost 65% of the pay.

The most glaring conclusion you can draw is that job status and pay are vastly improved if the employee of a workshop is sighted as opposed to blind. Most blind people work in direct labor jobs. The sighted supervise or manage. Top pay ($8.25 an hour) goes to the sighted. Bottom pay ($1.86 per hour) goes to the blind. That's what the figures show.

In a 1983 report released by the United States House of Representatives, Committee on Government Operations, the Committee for Purchase From the Blind and Other Severely Handicapped was directed to make certain improvements in its administration of the Javits-Wagner-O'Day program. (See 17th Report of the Committee on Government Operations, U.S. House of Representatives, 98th Congress, First Session, H. Rept. 98-546) Mr. Chairman, we are unaware that any but the most simple and technical improvements have been made. It is true that the Committee meetings (formerly closed) are now open. But the real change of direction signaled by the Government Operations' Committee Report has simply not occurred. Work opportunities for blind people in this program are still limited to low pay labor jobs, often with pay below the Federal minimum wage. Rarely do we find blind people in the management or supervisory positions where pay and responsibilities are better. These existing conditions fly in the face of the Government Operations Committee's Report and recommendations.

As a further attachment to my statement, I am submitting for the record a copy of last year's Report language which appeared in S. Rept. 99-133, the Report to accompany the bill making Treasury, Postal Service, and General Government appropriations for fiscal year 1986. This illustrates that relevant committees in both the House of Representatives and the Senate have expressed serious reservations about the administration of this program by the Committee for Purchase From the Blind and Other Severely Handicapped.

Of particular note in last year's Senate Report is the requirement that the Committee must justify its appropriations request by submitting: "Specific data in sufficient detail to make possible a comparison of employment opportunities, pay, and benefits which the CPBOSH program provides to (1) blind individuals, (2) other severely handicapped individuals, and (3) other individuals who are neither blind nor severely handicapped." These directives made in last year's Senate Report were an important first step toward the improvement of employment opportunities for blind and other severely handicapped individuals in the Javits-Wagner-O'Day program. However, the reporting has not occurred to the extent required by the Senate Report or in the spirit of that Report.

According to the executive director of the Committee for Purchase From the Blind and Other Severely Handicapped, the Office of Management and Budget has declined to approve amendments to the Committee's annual report and certification forms submitted by all eligible sheltered workshops. This suggests that if Congress wants to obtain better data to compare employment opportunities for the blind with those provided to the sighted, specific directives in the form of statutory language will have to be provided. Therefore, the appropriate proposed language for the 1987 appropriations bill is attached. It is particularly timely for Congress to act in strengthening the Committee's reporting system, since OMB's approval of the current annual workshop certification forms expires December 31, 1986. Straightforward reporting on employment opportunities and pay in the sheltered workshops and Central Nonprofit Agencies is only the beginning step for Congress to direct. Beyond that, it is essential that actual improvements in employment opportunities and pay for the blind and other severely handicapped must be ordered.

It is acknowledged that the Appropriations Committee may not have sufficient jurisdiction to alter in any significant way the eligibility criteria for sheltered workshops, since that criteria is set out in the underlying statute--the Javits-Wagner-O'Day Act. However, the Appropriations Committee may properly provide directives to the Committee for Purchase From the Blind and Other Severely Handicapped regarding criteria for the designation of Central Nonprofit Agencies involved in the administration of the Committee's program. Such guidance (as proposed in the attached statutory language) does not amend the underlying statute.

We believe that the Central Nonprofit Agencies (National Industries for the Blind and National Industries for the Severely Handicapped) should actually be model employers of blind and other severely handicapped persons. But, in last year's appropriations hearing before this Subcommittee, the executive director of the Committee for Purchase From the Blind and Other Severely Handicapped was unable to provide any information concerning employment opportunities and pay for the blind and other severely handicapped at the Central Nonprofit Agencies. Yet the latest information we have shows that, for example, out of a workforce of some 90 employees at National Industries for the Blind (NIB), only 4 are actually blind. And none of the employees who are blind at NIB occupy responsible, managerial positions.

This is what the House of Representatives, Government Operations Committee was referring to as "tokenism" when it discussed the underemployment of blind and severely handicapped persons in management and supervisory positions in sheltered workshops and the Central Nonprofit Agencies. From the facts we have at hand, it is clear to us that steps are not being taken to correct that condition. Congress must act, therefore, to provide a statutory basis for greater efforts by the Central Nonprofit Agencies to employ blind and other severely handicapped personnel. The statutory language I am offering includes such requirements.

Mr. Chairman, in concluding this statement I want to commend you and to express our strong appreciation to you for the interest and concern you obviously have in the issues of underemployment and low pay for blind and severely handicapped workers in the sheltered workshops and the Central Nonprofit Agencies that operate under the Javits-Wagner-O'Day Act. The appropriations amendments we are offering are designed to do what the Appropriations Committee can do within its limited jurisdiction. I trust that you will find this to be the case and you and your colleagues will therefore vote to include specific statutory language of the type we are suggesting. Toward that end, I pledge our fullest continuing cooperation, and I thank you.

FACT SHEET

CRISIS IN NONPROFIT MAIL RATES MEANS SERIOUS HARM TO THE BLIND

The Issue: During this session, Congress will decide whether federal funds will continue aiding the blind and others by meeting some of the costs for free and reduced rate mailings carried by the United States Postal Service (USPS). Many nonprofit organizations, such as the National Federation of the Blind (NFB) may not survive if forced to pay commercial postage rates. Yet, this would be the effect of budget proposals to terminate or reduce federal aid for nonprofit groups to use the mails.

Nonprofit Postage Rates Bring Help to the Blind: Holding the line on nonprofit postage rates will mean the difference between life or death for groups such as NFB which operate in the private sector. Voluntary initiatives made by the blind themselves without government expense (such as public education campaigns and drives for more employment opportunities for the blind) will decline or cease altogether if postage rates rise further. Materials and resources aimed at personal adjustment and self-help for the blind, provided without government cost, will not be available. Organized consultation by the blind themselves to assist in developing technology or to advise officials of public programs will not be possible. Communication links among the blind to share information, knowledge, and resources will be gone. Above all, the ability to encourage the blind toward self-betterment, growth, and productive living will be lost. This is tangible help made possible now because of federally provided special mail rates. The rates allow for educational communications and fundraising to enlist community, private sector support for the efforts of the blind to help themselves. NFB's programs help reduce dependency upon the government by the blind. That in itself is a benefit to all taxpayers. But if Congress decides not to use tax money to encourage these private initiatives, demand will rise from among the blind for more help from public agencies financed by state and federal tax dollars. Costs to the federal treasury for publicly run programs will rise while private efforts cease or suffer.

How Congress Can Help:

(1) Vote for a budget resolution containing sufficient authority for appropriations to maintain nonprofit postage rates at current levels.

(2) Vote for appropriations measures which provide sufficient funds so nonprofit postage rates will not increase further during 1986 or 1987. The FY 1986 appropriation is $748 million. $833 million may be needed for FY 1987, but the amount may be lower depending upon the outcome of budget reconciliation legislation and recommendations being studied by the Postal Rate Commission.

Current Crisis and Background: Under the 1970 Postal Reorganization Act federal revenues pay for mail service authorized by law at free or reduced rates. Communications by nonprofit organizations and "free matter for the blind and handicapped" directly benefit the blind. Political parties, newspaper and periodical publishers, schools, libraries, among others are also aided by the appropriation known technically as "revenue forgone."

This is a target in the current round of budget cuts. In 1981, 1982, and 1985, there were unsuccessful attempts to eliminate budget authority for the revenue foregone appropriation, but Congress wisely resisted. Again this year the President's budget has requested complete elimination of revenue foregone payments to USPS. Under that budget, no funds would be available to mail books for the blind postage free or to support use of the mails on behalf of the blind by NFB and other nonprofit groups.

8.7 cents per piece is the current third-class nonprofit rate. At the beginning at 1985 the comparable rate was 5.2 cents per piece. If the budget plan wins out to eliminate the revenue foregone payment, the third-class nonprofit postage rate would be increased to the commerical rate, and for the first time books for the blind would have to be sent at prohibitively expensive commercial postage rates. 12.5 cents per piece is the commercial third-class rate. This would be the amount charged to nonprofit organizations without adequate appropriations to meet the difference. At the 12.5 cent third-class per piece rate, an organization mailing one million pieces would pay $125,000, as opposed to $87,000 for a similar mailing presently. If a nonprofit group mails ten million pieces annually (many do), a postage rate increase of one cent will result in an increased postage charge of $100,000 for that group. That increase may mean the difference between continuing to provide help or closing down altogether because postage costs are too high.

Paying more to USPS for postage takes money directly from program services which now help the blind. It would also be impossible to contact new potential contributors to raise additional revenues. If communications with blind persons and the public at large are cut, a time bomb is created, since fewer people will understand anything about blindness and even fewer will know of the continuing need to help. The inevitable result is a downward spiral, with fewer people helped and fewer people helping. Soon the self-help organizations of the blind will be destroyed. These are the unanticipated ripple effects of rising postal rates, but they are nonetheless very real. The ability to communicate at an affordable cost is vital. Without it, many worthy efforts on behalf of the nation's blind will diminish or die altogether. Since fifty thousand Americans become blind each year, there must either be continued widespread mailings to the general public to inform them about blindness and how to deal with it or else an increasing number of the newly blinded will not be found until it is too late and they are hopelessly doomed to continuing dependence.

Calendar No. 283

99TH CONGRESS
1st Session
SENATE
REPORT
99–133

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATION BILL, 1986

COMMITTEE FOR PURCHASE FROM THE BLIND AND OTHER SEVERELY HANDICAPPED

1985 appropriation to date	$710,000
1986 budget estimate	749,000
House allowance	730,000
Committee recommendation	730,000

The Committee recommends the full budget request of $730,000 for the Committee for Purchase From the Blind and Other Severely Handicapped.

The Committee's primary objective is to increase the employment opportunities for the blind and other severely handicapped and, whenever possible, to prepare them to engage in normal competitive employment. The Committee determines which commodities and services are suitable for Government procurement from qualified nonprofit agencies serving the blind and other severely handicapped; publishes a procurement list of such commodities and services; determines the fair market price for commodities and services on the procurement list; and makes rules and regulations necessary to carry out the purposes of the act.

The Committee staff supervises the selection and assignment of new commodities and services, assists in establishing prices, reviews and adjusts these prices, verifies the qualifications of workshops, and monitors their performance.

REPORTS FROM THE COMMITTEE FOR PURCHASE FROM THE BLIND AND OTHER SEVERELY HANDICAPPED

The Committee is concerned over reports that the Committee for Purchase from the Blind and Other Severely Handicapped [CPBOSH] may be failing to provide adequately for expanding employment opportunities for blind and severely handicapped individuals. Particularly, there is evidence that blind and severely handicapped people are not recruited or promoted into management or supervisory positions in the sheltered workshops or in the central nonprofit agencies. These agencies (National Industries for the Blind and National Industries for the Severely Handicapped) are designated by CPBOSH to operate on its behalf in administering this program and function directly under CPBOSH jurisdiction. Yet, there is evidence that the employment practices of the central nonprofit agencies (especially with respect to recruitment and promotion of blind and severely handicapped individuals) have not been closely monitored by CPBOSH. Also the Committee needs more complete financial information to assess the operations of these instrumentalities which participate substantially in the administration of the CPBOSH Program.

The Committee believes that the sheltered workshops and the central nonprofit agencies should become model employers for the utilization of blind and other severely handicapped individuals in all positions and at all levels of responsibility. To aid CPBOSH in achieving these goals, justifications submitted to the Committee, beginning with the 1987 appropriations request shall include specific data in sufficient detail to make possible a comparison of employment opportunities, pay, and benefits which the CPBOSH Program provides to: (1) blind individuals, (2) other severely handicapped individuals, and (3) other individuals who are neither blind nor severely handicapped. Specific data shall also be included to show the positions, pay, and benefits provided to blind individuals employed by National Industries for the Blind as compared to the positions, pay, and benefits provided to sighted individuals employed by that agency. Similar information shall likewise be submitted with regard to employment opportunities provided by National Industries for the Severely Handicapped.

The Committee is also advised that a substantial portion of the revenues expended to administer the CPBOSH Program are derived from commissions paid to the central nonprofit agencies from purchases made by the Government. The commission revenues finance the central nonprofit agencies and provide over 90 percent of the funding for this program. These payments derived from Federal purchases are above and beyond the amount appropriated directly for salaries and expenses of the CPBOSH. Beginning with the fiscal year 1987 appropriations request, CPBOSH is directed to submit cost information showing how the commission rate paid to each central nonprofit agency is justified. Such information shall also include the audited financial statement of each central nonprofit agency for the fiscal year just ended, a financial operating statement up to date for the fiscal year in progress, and a budget for the fiscal year in progress at the time the justifications are submitted.

PROPOSED APPROPRIATIONS LANGUAGE

Committee for Purchase From the Blind and Other Severely Handicapped

Salaries and Expenses

For necessary expenses of the Committee for Purchase From the Blind and Other Severely Handicapped established by the Act of June 23, 1971, Public Law 92-28, including hire of passenger motor vehicles: $779,000: Provided, That none of the funds made available to the Committee for Purchase From the Blind and Other Severely Handicapped by this Act shall be used to administer the program authorized pursuant to Public Law 92-28 through the designation of any Central Nonprofit Agency, as authorized in the Act which fails to employ blind or other severely handicapped individuals to fill at least 50% of all existing or future job vacancies, with the priority that the Central Nonprofit Agency or each such Agency shall promote or recruit blind or severely handicapped individuals into all existing and future vacancies in management and supervisory positions: Provided further, That the Committee for Purchase From the Blind and Other Severely Handicapped shall submit to the Appropriations Committee of the Senate and the Appropriations Committee of the House of Representatives respectively a report, in conjunction with each year's annual appropriations request containing specific data in sufficient detail to make possible a comparison of employment opportunies, pay, and benefits (including such opportuntiies, pay, and benefits in management and supervisory positions) which the Central Nonprofit Agencies and qualified nonprofit agencies for the blind and other severely handicapped provide to (1) blind individuals, (2) other severely handicapped individuals, and (3) other individuals who are neither blind nor severely handicapped.

CONCLUSION OF HEARINGS

Senator ABDNOR. So, at this time, if there is no further business, to come before the subcommittee, we'll stand in recess, subject to a call of the Chair.

[Whereupon,at 4:07 p.m., Wednesday, April 16, the hearings were concluded, and the subcommittee was recessed, to reconvene at the call of the Chair.]

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